

## **New Fiscal Plan for Puerto Rico**

# Restoring Growth and Prosperity

**As certified by the Financial Oversight and Management  
Board for Puerto Rico**

October 23, 2018

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- *The amount and timing of receipt of any distributions from the Federal Emergency Management Agency and private insurance companies to repair damage caused by Hurricanes Maria and Irma;*
- *The amount and timing of receipt of any amounts allocated to Puerto Rico and provided under the Community Disaster Loans Program;*
- *The amount and timing of receipt of any additional amounts appropriated by the United States government to address the funding gap described herein;*
- *The timeline for completion of the work being done by the Puerto Rico Electric Power Authority ("PREPA") to repair PREPA's electric system and infrastructure and the impact of any future developments or issues related to PREPA's electric system and infrastructure on Puerto Rico's economic growth;*
- *The impact of the measures described herein on outmigration; and*
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**List of Acronyms and Key Terms**

AAFAF	Puerto Rico Fiscal Agency and Financial Advisory Authority (Spanish acronym)
ADEA	Agricultural Enterprise Development Administration (Spanish acronym)
Administration	Administration of Governor Ricardo Rosselló
ASEM	Puerto Rico Medical Services Administration (Spanish acronym)
ASES	Puerto Rico Health Insurance Administration (Spanish acronym)
CAFR	Comprehensive Annual Financial Report
CAGR	Compound Annual Growth Rate
CBO	Congressional Budget Office
CDBG	Community Development Bank Grant
CHIP	Children's Health Insurance Program (CHIP)
COFINA	Puerto Rico Sales Tax Financing Corporation (Spanish acronym)
COSSEC	Public Corporation for the Supervision and Deposit Insurance of Puerto Rico Cooperatives (Spanish acronym)
CRRO	Central Recovery and Reconstruction Office
DCR	Department of Corrections and Rehabilitation
DB	Defined Benefit pension plan
DC	Defined Contribution pension plan
DDEC	Puerto Rico Department of Economic Development Commerce (Spanish acronym)
DOH	Department of Health
DOJ	Department of Justice
DPS	Department of Public Safety
DSA	Debt Sustainability Analysis
EITC	Earned Income Tax Credit
ERS	Employee Retirement System
FDI	Foreign Direct Investment
Federal Government	The U.S. Federal Government
FEMA	Federal Emergency Management Agency
FMAP	Federal Medical Assistance Percentage (FMAP)
FOMB	Financial Oversight and Management Board for Puerto Rico
FQHC	Federally Qualified Health Center
FYTD	Fiscal-Year-To-Date
GAO	U.S. Government Accountability Office
GDB	Government Development Bank for Puerto Rico
GDP	Gross Domestic Product
GF	General Fund
GFEWG	Governor's Fiscal and Economic Working Group
GNP	Gross National Product
Government	Government of Puerto Rico
Governor	Governor Ricardo Rosselló
Hacienda	Puerto Rico Department of Treasury
HHS	U.S. Department of Health and Human Services
HUD	U.S. Department of Housing and Urban Development
Hurricanes	Hurricane Irma and Hurricane Maria
IFCU	Independently Forecasted Component Units
IMF	International Monetary Fund
IPR	Invest Puerto Rico
Island	Puerto Rico
KPIs	Key Performance Indicators
LEA	Local Education Agency
March 2017 Fiscal Plan	Fiscal Plan certified by the Financial Oversight and Management Board in March 2017, before Hurricanes Maria and Irma hit the Island
MADs	Maximum Annual Debt service
MCOs	Managed Care Organizations
MFCU	Medicaid Fraud Control Units
Mi Salud	Medicaid program in Puerto Rico
MMIS	Medicaid Management Information System
NAP	Nutrition Assistance Program (Spanish: Programa de Asistencia Nutricional, PAN)
NRW	Non-Resident Withholdings
OCFO	Office of the CFO
OMB	Office of Management and Budget
P3	Public Private Partnerships
P3 Authority	Public Private Partnership Authority
PA	Public Assistance
Parties	AAFAF and the Government
PayGo	New pensions program by which agencies and instrumentalities are responsible for paying their pensions obligations on an annual basis via a "PayGo Charge"
PBA	Public Buildings Authority
Platino	Medicare Advantage program that also provides Medicaid wraparound services equivalent to Mi Salud program

PMO	Program Management Office
MPPM	Per Member Per Month
PRASA	Puerto Rico Aqueduct and Sewer Authority
PRCCDA	Puerto Rico Convention Center District Authority
PRDE	Puerto Rico Department of Education
PREB	Puerto Rico Energy Bureau
PREMA	Puerto Rico Emergency Management Agency
PREPA	Puerto Rico Electric and Power Authority
PRHFA (or HFA)	Puerto Rico Housing Finance Authority
PRHTA (or HTA)	Puerto Rico Highway and Transportation Authority
PRIDCO	Puerto Rico Industrial Development Company
PRITS	Puerto Rico Information Technology Service
PROMESA	Puerto Rico Oversight, Management and Economic Stability Act
PRTC	Puerto Rico Tourism Corporation
PSC	Puerto Rico Public Service Commission
RFQP	Request for Proposal
SCO	State Coordinating Officer
SRF	Special Revenue Fund
SR	Structural Reform
SUT	Sales and Use Tax
SIFC	State Insurance Fund Corporation
TANF	Temporary Assistance for Needy Families
UPR	University of Puerto Rico
WIOA	Workforce Innovation and Opportunity Act

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## EXECUTIVE SUMMARY

**The people of Puerto Rico need and deserve** plentiful good jobs, a dynamic and prosperous economy, affordable and reliable electricity, and an efficient and responsive public sector—but have not had any of these things for more than a decade. Instead, since 2005, the number of people living under the poverty level has increased, the economy has shrunk, electricity has remained expensive and unreliable, labor market regulations have remained burdensome—hindering job creation for the people—and the public sector has provided declining levels of service at a high cost to citizens. These problems predate Hurricanes Maria and Irma and will continue to plague Puerto Rico long after it recovers from the storms unless a bold set of fiscal and structural reforms are implemented.

Based on much of the Government's proposed fiscal plan, this New Fiscal Plan for the Commonwealth (the "New Fiscal Plan") outlines a number of the structural reforms and fiscal measures that, **if implemented by this Government, will help to provide Puerto Ricans with a positive economic trajectory, a twenty-first century electricity grid, resilient infrastructure, and a more effective and efficient public sector.** Full implementation of this New Fiscal Plan will also put Puerto Rico on the path to meeting the core objectives laid out in the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA): achieving fiscal responsibility and balance within five years and regaining access to the capital markets.

While this New Fiscal Plan includes many of the critical reforms needed to improve the Island's fiscal balance and economic conditions, **there are some important reforms that are not included in this New Fiscal Plan because the political will to adopt them does not exist.** Chief among these is labor reform, which is essential to truly unlocking growth and prosperity for the Island and driving fiscal sustainability in the long-term. A comprehensive, pro-growth tax overhaul is another reform that would materially improve Puerto Rico's competitiveness and economy, if there was political will to pursue it.

Therefore, while this New Fiscal Plan provides for many actions that the Government of Puerto Rico must take, **unless the Government commits to more ambitious reforms, Puerto Rico will not be able to overcome all of the problems that have plagued its economy for over a decade,** and the Government will have lost a critical window of opportunity to restore long-term fiscal sustainability and achieve long-term economic growth and prosperity for the people of Puerto Rico.

\* \* \*

**Puerto Rico has been mired in an economic and demographic downward spiral for over a decade.** The economy is \$16 billion smaller in real terms and the population is nearly half a million smaller (largely due to outmigration) than it was in 2005 – trends that, before Hurricane Maria, were projected to continue.<sup>1</sup> Today, over 40% of the population lives below the poverty line, over 40% are dependent on Medicaid for healthcare. Over 10% of the population has left or is projected to leave the Island in the next five years to seek a better life elsewhere, with the median age on the Island projected to rise from 42 in FY2018 to 52 by FY2058. Meanwhile, the consolidated Commonwealth's outstanding debt and pension liabilities have grown to over \$120 billion, with more than \$70 billion in financial debt and more than \$50 billion in pension liabilities—an amount almost twice the size of Puerto Rico's economy.

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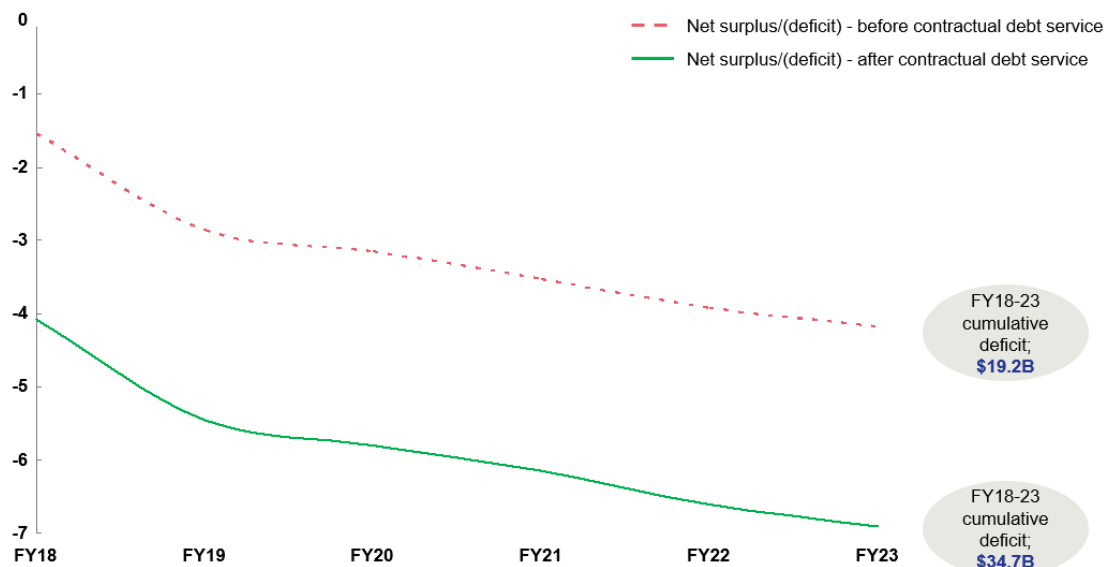
<sup>1</sup> The World Bank Group projections

These pre-Maria problems are not new and temporary—they are long-standing and structural. For decades, the private sector has been overly reliant on now expired federal tax advantages while having to operate in a difficult business climate with poor infrastructure and expensive and unreliable electricity and transit systems. Other challenges include a public sector that is significantly larger than that of a typical U.S. state yet often has provided low-quality service, as well as a labor force participation rate that is among the lowest in the world.

Puerto Rico has also had a fiscal management challenge for years, with actual revenues lower and actual expenses higher than projected, creating a growing general fund deficit (**Exhibit 1**). This general fund deficit is difficult to forecast with certainty, however, because of the protracted delays in issuing annual audited financial statements, lack of proper fiscal controls, and poor financial management. Puerto Rico has also been in an economic structural decline for over a decade, which has meant an eroding tax base. Even before Maria, the annual primary deficit was growing. To finance these primary deficits, Puerto Rico resorted to issuing debt which became unsustainable. As the Oversight Board began its work in 2016, the Commonwealth was projected to run structural annual deficits exceeding \$7 billion, or \$3 billion before debt service.

**EXHIBIT 1: PROJECTED PRE-MARIA DEFICIT BEFORE MEASURES AND STRUCTURAL REFORMS (PRE- AND POST- CONTRACTUAL DEBT SERVICE)**

Puerto Rico pre-Fiscal Plan deficit before Hurricane Maria, \$B



**It was amidst these protracted demographic, fiscal, and debt crises that Hurricanes Maria and Irma hit the Island.** Hurricane Maria has caused unprecedented and catastrophic damage to Puerto Rico, its people, and its businesses. According to current estimates, Hurricane Maria has created tens of billion in damage<sup>2</sup>, and is estimated to have caused a real decline to GNP of 8% in FY2018. On the other hand, over \$80 billion in federal funding is projected to be invested in helping Puerto Rico recover and rebuild from Hurricane Maria. The New Fiscal Plan is thus written assuming substantial and timely support from the Federal Government. While Puerto Rico will likely experience a brief stimulus from this federal disaster relief funding and is benefiting from a temporary reprieve from debt service due to PROMESA and Title III, Puerto Rico must change its underlying economic foundations

<sup>2</sup> Based on federal estimates as of September 2018

to prevent fiscal imbalances from inevitably returning. Only by attacking the structural problems plaguing Puerto Rico will it have laid the groundwork for a new, growing, resilient economy.

**Puerto Rico must urgently adopt a series of bold actions to improve its fiscal and economic trajectory.** These reforms and measures are essential to restoring growth, opportunity, and prosperity to the people and businesses of Puerto Rico, and to making the Government of Puerto Rico more efficient, effective, and responsive to its citizens.

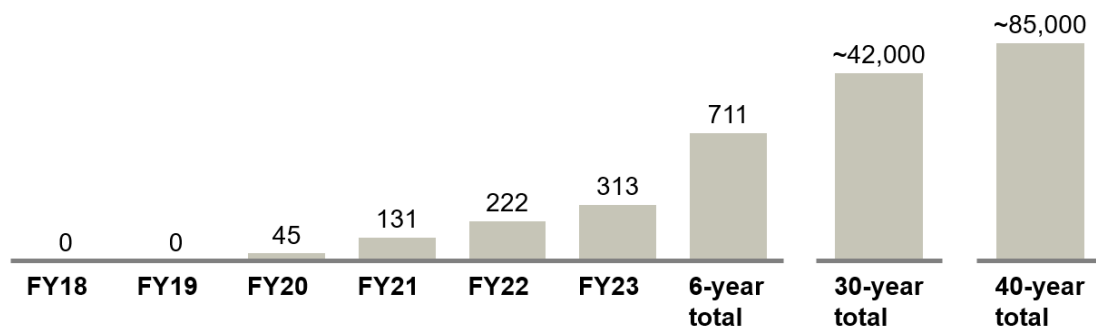
### Structural reforms

The New Fiscal Plan proposes a series of reforms (“structural reforms”) to improve the trajectory of the economy and drive growth (**Exhibit 2**):

- *Human capital and welfare reform:* Promoting participation in the formal labor force by creating incentives to work through Earned Income Tax Credit (EITC) benefits and Nutritional Assistance Program (NAP) reform, as well as providing comprehensive workforce development opportunities. EITC and NAP reform are projected to increase economic growth by 0.15% by FY2021, and education and workforce development opportunities are projected to add an additional 0.26% from FY2033-2058.
- *Ease of doing business reform:* Promoting economic activity and reducing the obstacles to starting and sustaining a business in Puerto Rico through comprehensive reform to improve ease of paying taxes, registering property, and obtaining permits. These reforms are projected to drive a 0.50% uptick in overall growth by FY2022.
- *Power sector reform:* Providing low-cost and reliable energy through the transformation of PREPA and establishment of an independent, expert, and well-funded energy regulator. This is projected to increase growth by 0.30% starting in FY2020.
- *Infrastructure reform:* Prioritizing economically transformative capital investments with federal funds.

#### EXHIBIT 2: IMPACT OF STRUCTURAL REFORMS

Impact of structural reforms, \$M

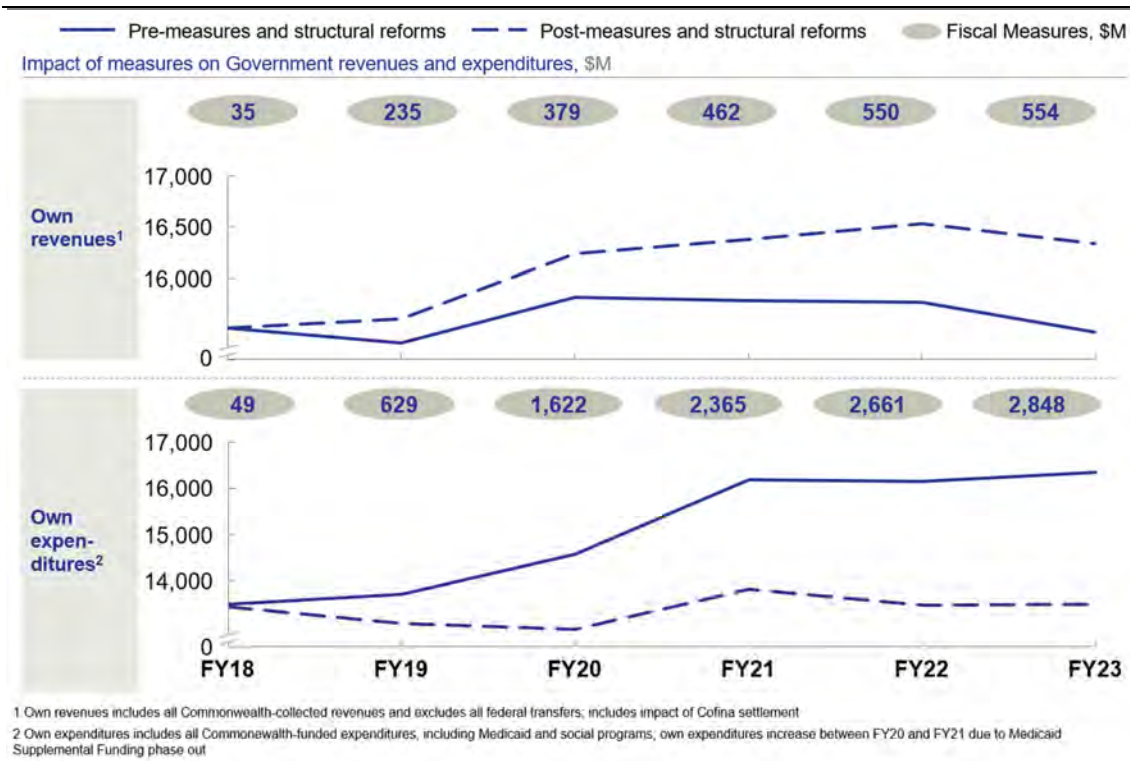


### Fiscal measures

The New Fiscal Plan proposes a set of fiscal actions that the Government must take (“measures”) to increase Government revenues and reduce Government expenditures (**Exhibit 3**):

- *Creation of Office of the CFO:* Instituting fiscal controls and accountability, reducing special revenue fund deficits, and improving governance, accountability, and transparency
- *Agency efficiencies:* Consolidating agencies and deploying new management tools and practices to deliver better governmental services for substantially lower cost
- *Healthcare reform:* Reducing healthcare cost inflation through a comprehensive new healthcare model that prioritizes high quality, cost-effective care
- *Enhanced tax compliance and optimized taxes and fees:* Employing new technology and other innovative and now commonly used practices in other jurisdictions to broaden the tax base, reduce fraud, and improve fairness to boost overall tax revenues; adjusting existing taxes and fees to capture revenues from under-leveraged sources
- *Reduction of appropriations:* Lowering the fiscal burden on the Commonwealth and encouraging sound fiscal self-management by reducing appropriations to municipalities and the University of Puerto Rico, while instituting an independent scholarship fund for low-income UPR students
- *Comprehensive pension reform:* Improving the financial stability of public employees' retirement funds and ensuring payment of pensions

EXHIBIT 3: IMPACT OF REVENUE AND EXPENDITURE MEASURES ON OWN REVENUES AND EXPENDITURES<sup>3</sup>

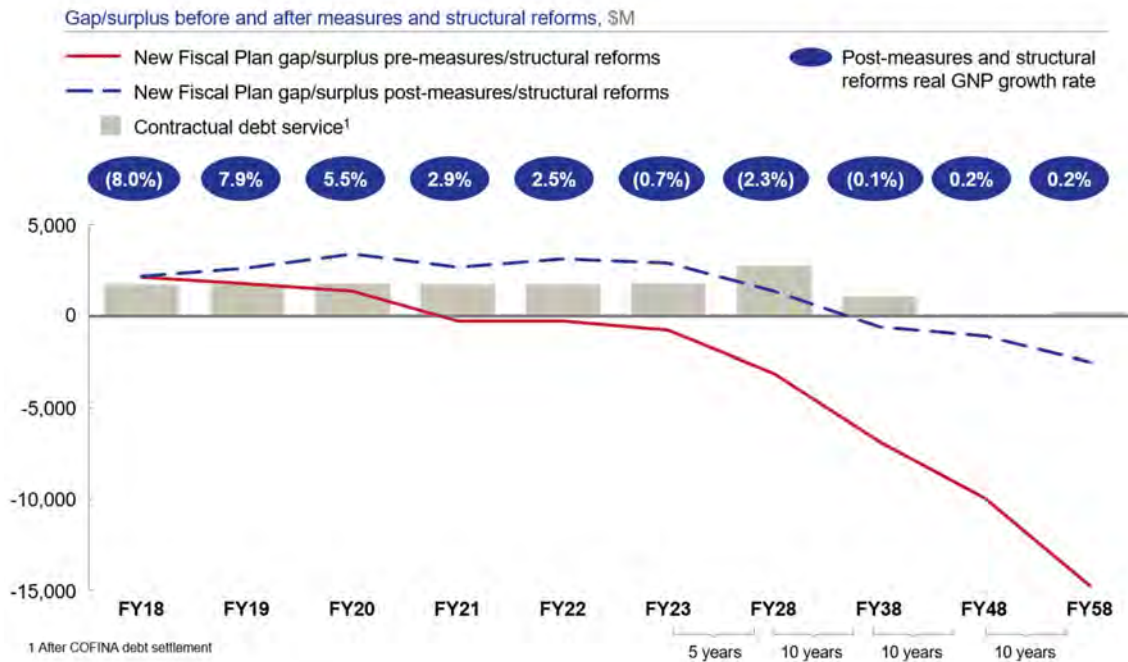


**Implementing these structural reforms and fiscal measures**, which will provide low-cost and reliable energy, robust infrastructure, more incentives to enter the formal labor market, an improved regulatory and permitting environment, and a more effective and

<sup>3</sup> The 40-year surplus reflects forward looking 40-years plus FY18 actuals.

efficient public sector, will improve the economy and services provided for the people of Puerto Rico.

EXHIBIT 4: NEW FISCAL PLAN PROJECTED SURPLUS BEFORE AND AFTER MEASURES AND STRUCTURAL REFORMS



**The Government of Puerto Rico cannot afford to meet all its contractual debt obligations, even with aggressive implementation of these reforms and measures.** Puerto Rico is committed to repaying an affordable and sustainable amount of its outstanding debt. However, Puerto Rico needs a comprehensive restructuring of its debt—in addition to the adoption of pro-growth structural reforms—to have renewed access to capital markets and to create the basis for a sustainable economy. The best time to implement these reforms and restructure the debt is while Puerto Rico has the temporary benefits of federal disaster relief funding and a stay on debt service. Therefore, time is of the essence. The New Fiscal Plan lays out a prudent and integrated set of actions to restore fiscal balance in the short and medium term and outlines opportunities for more ambitious additional reforms to create a vibrant economy in the long term.

Such additional ambitious reforms are necessary because the New Fiscal Plan projects deficits from FY2034 onward (**Exhibit 4**). That means a Puerto Rico government in the near future **will be required to take additional measures that go beyond the five-year framework of this New Fiscal Plan to be able to have balanced budgets and a growing economy.** Many of these reforms—which would reduce deficits and therefore make funds available for a variety of potential uses, including reinvestment in the people of Puerto Rico—have been proposed by the Oversight Board, but the Oversight Board cannot implement them without the support of Puerto Rico’s elected Government, which to date has not been willing to do so.

# PART I: Context for Puerto Rico's current economic and fiscal challenges

## Chapter 1. LONG-TERM ECONOMIC TRENDS IN PUERTO RICO

Before being hit by the most powerful hurricane to strike the Island in almost a century, Puerto Rico's economy had been in an acute structural decline for over a decade, the Government had defaulted on debt exceeding the size of Puerto Rico's annual gross national product (GNP), and nearly half of Puerto Ricans lived below the national poverty line. The reasons for these problems are multiple, but the root causes stretch back 40 years.

In the 1940s and 1950s, led by Operation Bootstrap, Puerto Rico's economy grew rapidly and productivity increased by 5% per annum as it transitioned from an agricultural-led to a manufacturing-led economy. However, as economic performance began to decline in the 1970s, the Federal Government adopted two significant policies to help Puerto Rico shore up its economy.

First, transfer programs increased dramatically, particularly as Puerto Rico started receiving Nutritional Assistance Program (NAP) funding, eventually providing, in aggregate, a proportion of residents' personal income that was twice the U.S. mainland average. In addition to raising costs for the Government, these programs at times created disincentives to work due to benefits that were high relative to wages available in the formal labor market.

Second, in 1976, Section 936 of the federal tax code was introduced to promote investments by companies that could transfer their "intangible assets" to Puerto Rico, and thereby shift profits to the Island. These Section 936 companies, which were mostly in pharmaceuticals and life sciences, became a pillar of Puerto Rico's economy, creating valuable local supply chains and local banking deposits, and contributing substantial tax revenue. In the same year, Puerto Rico passed Law 80, which instituted protections against wrongful discharge for Puerto Rican workers and mandated severance for firms attempting to remove employees. This law made Puerto Rico's labor market significantly more rigid and placed it out of step with the prevailing labor markets in the mainland U.S. (especially markets with which Puerto Rico competes for companies and talent, such as Florida).

In 1996, Congress decided to end Section 936, gradually phasing it out by 2006. In the face of an anemic local private sector, the Government also expanded its employment to the point that by 2000, 30% of Puerto Rico's jobs were in Government and a full 40% of workers with college degrees worked in the public sector. Major sectors like water, electricity and ports are still run by public corporations, and have consistently created a drain on the economy by delivering lower quality services at high costs while crowding out private investment. There is also pervasive cross-subsidization among the Commonwealth, public corporations and other parts of the public sector that obfuscates financial management and accountability. Finally, there is a high degree of political interference in decisions that affect every aspect of Puerto Ricans' lives. As a result, today Puerto Rico underperforms on all important measures of a modern economy, including educational attainment, cost of electricity, quality of water, tax compliance, and labor market participation.

To promote the private sector, the Government undertook a broad tax incentives policy that led to a highly complex web of subsidies and special tax arrangements. These actions neither

promoted growth nor treated companies equitably. Furthermore, generous government and federal transfer programs boosted incentives that resulted in many workers choosing either not to work or to receive benefits and work in the informal economy without paying taxes. Tax compliance has never been adequate in Puerto Rico, and it became increasingly difficult in this environment.

Government revenues suffered and became increasingly hard to forecast. To make up for this recurring and growing budgetary shortfall, the Commonwealth turned to debt markets. Puerto Rico bonds found themselves in every corner of the U.S. bond market and, as investor appetite began to wane, the Government turned to securing new debt by pledging various revenue streams. The result was a highly complex financial structure that limited transparency as well as financial accountability and management.

When the Great Recession hit in 2008, Puerto Rico's economy was already in a fragile fiscal and financial position. Since then, the economy has continued to worsen – Puerto Rico has seen its GNP shrink by 20%, labor participation has fallen to a record low of 38%, and the Island's population has fallen by 10%. Today, Puerto Rico is much poorer relative to the U.S. than it was in 1970.

## Chapter 2. ENACTMENT OF PROMESA

By 2016, Puerto Rico had accumulated over \$50 billion in unfunded pension liabilities and over \$70 billion of debt, and was facing an imminent default. Because Puerto Rico and its public corporations cannot take advantage of Chapter 9 of the U.S. Bankruptcy Code, and an attempt to create a territorial bankruptcy law was struck down by the U.S. Supreme Court, Congress stepped in to head off Puerto Rico's financial and debt crisis by passing PROMESA, the Puerto Rico Oversight, Management, and Economic Stability Act. PROMESA imposed an automatic stay on Puerto Rico's debt obligations and created the Financial Oversight and Management Board for Puerto Rico (the "FOMB" or "Oversight Board"). The Oversight Board is tasked with restructuring Puerto Rico's staggering debt burden and restoring sustained economic growth to Puerto Rico so that the Government can achieve fiscal balance and access to the capital markets.

Immediately after its formation, the Oversight Board began working with the Government of Puerto Rico to create a fiscal plan that would help the Government achieve fiscal responsibility and regain access to the capital markets. The outcome of this work was the Commonwealth Fiscal Plan that the Oversight Board certified on March 13, 2017 (the "March 2017 Certified Fiscal Plan"). A few months later, the Oversight Board filed for Title III for the Commonwealth Government, COFINA, HTA, ERS, and PREPA.

In September 2017, just months after the certification of the March 2017 Fiscal Plan, Hurricanes Irma and Maria struck the Island, causing great devastation and fundamentally altering the Island's macroeconomic reality, and ultimately requiring a new Fiscal Plan.

## Chapter 3. IMPACT OF HURRICANES MARIA AND IRMA

On September 6, 2017 and September 20, 2017, Hurricanes Irma and Maria struck Puerto Rico, causing unprecedented humanitarian, economic, and infrastructure-related damages and upending the daily lives of Puerto Rico's over three million residents. Thousands of

residents were left homeless, basic utilities were completely shut down (and took months to become operational), and schools, hospitals, and businesses were destroyed. Tens of thousands of Puerto Ricans fled the Island. The Federal Government's response has become one of the largest and most complex disaster recovery efforts in U.S. history.

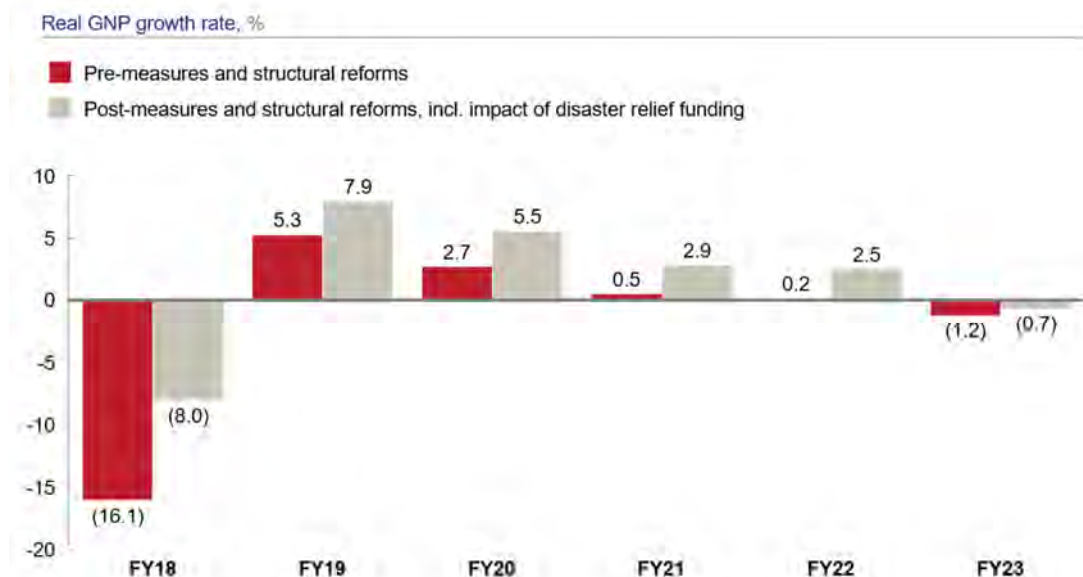
The damage inflicted on Puerto Rico by Hurricane Maria required that the March 2017 Certified Fiscal Plan be revised. Therefore, on October 31, 2017, the Oversight Board formally requested that the Government submit a revised fiscal plan for the Commonwealth and its instrumentalities. After months of hard work, engagement with stakeholders, and intense negotiations with the Government, the Oversight Board determined that the fiscal plan complied with the requirements of PROMESA, and accordingly, certified it in April 2018. Due to further Government and Oversight Board discussions concerning the repeal of Law 80, the Oversight Board certified an updated fiscal plan in May 2018. Given the lack of political will to pass much needed labor reform, the Oversight Board updated and certified an updated fiscal plan in June 2018. That plan served as the basis for the FY2019 Budget. The New Fiscal Plan has been subsequently updated to reflect actual revenue and expenditure numbers, refined healthcare projections based on actuarial estimates, new federal fund estimates, and changes in Government policy that may impact overall growth.

## PART II. Puerto Rico's path to fiscal and economic sustainability

### Chapter 4. MACROECONOMIC AND DEMOGRAPHIC TRAJECTORY POST-MARIA

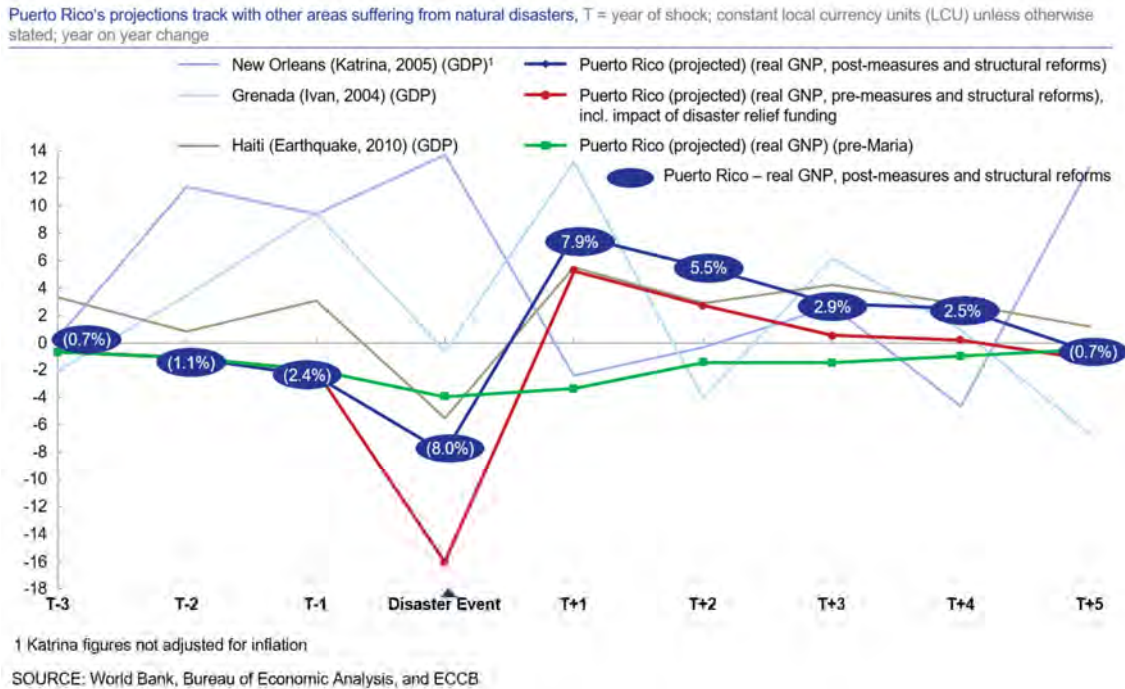
The New Fiscal Plan must grapple with how the shock of Hurricanes Irma and Maria will create a new economic reality for Puerto Rico in the years to come. Given this context, the New Fiscal Plan includes a forecast of the near-term macroeconomic volatility in the wake of the storms. In FY2018, there was a significant decline in economic activity after the storms, followed by a bounce-back that continues into FY2019. **Exhibit 5** shows pre- and post-measures, structural reforms GNP for the period of the Fiscal Plan.

EXHIBIT 5: REAL GNP GROWTH RATE BEFORE AND AFTER MEASURES, STRUCTURAL REFORMS, AND DISASTER RELIEF FUNDING



This trendline has similarities to the growth trendline faced by other jurisdictions that have suffered from major natural disasters (**Exhibit 6**).

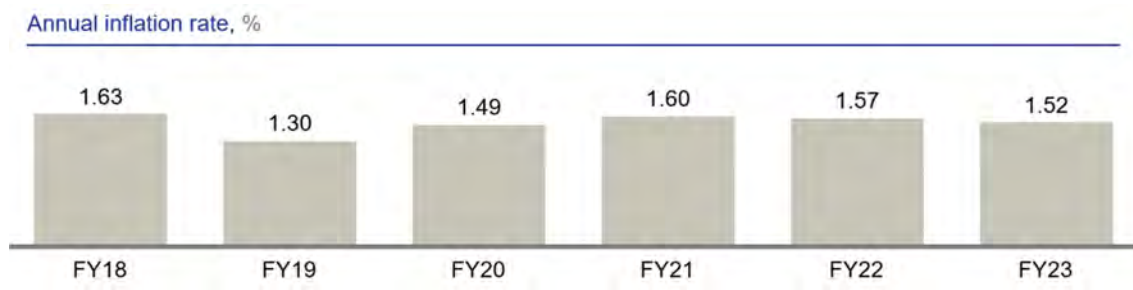
# EXHIBIT 6: PUERTO RICO'S PROJECTED GROWTH TRAJECTORY COMPARED TO OTHER JURISDICTIONS AFTER NATURAL DISASTERS



The economic outlook model, which forecasts GNP growth, primarily relies on a comprehensive data set on the Puerto Rican economy from 1965 to 2017. It includes dozens of variables that collectively describe the Puerto Rican economy (e.g., growth, population, capital stock, etc.),<sup>4</sup> and is largely impacted by four major factors: a) the pre-hurricane trendline of Puerto Rico, b) short- and long-term impacts from the storm on economic activity and capital stock, c) the stimulative impact of disaster relief assistance (discussed in *Section 4.1*), and d) proposed fiscal measures and structural reforms (discussed in *Section 4.2*).

Puerto Rican growth projections are also impacted by U.S. mainland growth projections, which in the New Fiscal Plan are derived from the Congressional Budget Office (CBO) projections. The New Fiscal Plan also uses CBO U.S. inflation projections. Puerto Rican inflation projections are summarized in **Exhibit 7**.

## EXHIBIT 7: ANNUAL INFLATION RATE



<sup>4</sup> The forecast relies on a 60-year comprehensive dataset and applying statistical regressions to show the effects of multiple yet distinct inter-related components of past hurricanes, exogenous developments, and economic policies on growth and inflation

#### 4.1 Disaster relief spending

Disaster spending tends to have a short-term stimulative effect on an economy post-crisis (though not in the long term).<sup>5</sup> In Puerto Rico, the level of public and private disaster relief spending is anticipated to be significant when compared to the overall size of the economy. Public and private disaster relief spending will impact the economy in two ways in the short term:

- **Short-term stimulative impact caused by spending on the Island that is expected to be more than 100% of the Island's projected 2018 GNP.** This stimulus can come in multiple forms such as construction companies hiring local, unemployed workers or workers from the mainland U.S. paying local withholding taxes and spending money for food and lodging.
- **Expected refurbishment of the capital stock on the Island.** The New Fiscal Plan factors in significant damage to capital stock that is repaired, in large part, by this significant infusion of federal and private monies, contributing to the bounce-back anticipated in FY2019 and for the bump in growth above pre-Maria trend thereafter.






**The New Fiscal Plan projects that ~\$82 billion of disaster relief funding in total, from federal and private sources, will be disbursed in the reconstruction effort.** It will be used for a mix of **individual assistance** (e.g., reconstruction of houses, personal expenditures related to the hurricane such as clothing and supplies), **public assistance** (e.g., reconstruction of major infrastructure, roads, and schools), and to cover part of **the Commonwealth's share of the cost of disaster relief funding** (states often must match some portion of federal public assistance spend<sup>6</sup>).

Of that, **~\$66 billion** is estimated to be used for **public assistance** (between FEMA, CDBG, supplemental funding from other federal agencies, and funding covering cost match obligations incurred by the Commonwealth and instrumentalities), **~\$3 billion for individual assistance** (between FEMA and CDBG funds), **~\$8 billion** will be used for **private and business insurance** pay outs, and **\$5 billion** is related to other federal funding. **\$3.4 billion** in CDBG funding is estimated to be allocated to offset the Commonwealth's and its entities' **expected cost-share requirements** under federal programs over seven years. This portion of CDBG funding will go towards covering the ~10% cost share burden on expenditures attributable to the Commonwealth, PREPA, PRASA, and HTA for the first seven years of expenditures, given statutory requirements regarding the timeline of CDBG spending. This estimated ~10% cost share comes from a weighted average of all categories of FEMA Public Assistance funding expected to go toward Puerto Rico, and is informed by specific FEMA cost share guidelines (**Exhibit 8**).

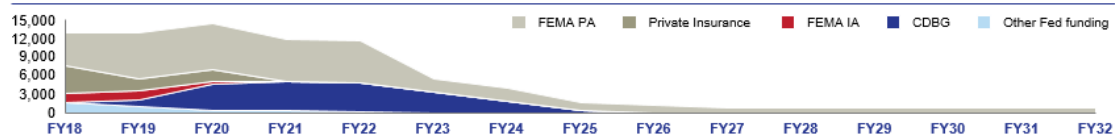
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<sup>5</sup> Relief aid after the Haitian Earthquake represented nearly 200% of overall GDP, providing a major economic "cushion" after the disaster. In Grenada, disaster aid after Hurricane Ivan (2005) equaled about two-thirds of GDP at the time, and after declines in growth immediately following the hurricane, Grenada's economy grew at a faster rate than any year since 1985, at a clip of 12.5%. However, revenues returned to pre-storm levels after about two fiscal quarters

EXHIBIT 8: PROJECTED PRIVATE AND PUBLIC DISASTER RELIEF FUNDING AND ROLL OUT

	FY18, \$M, %	FY19, \$M, %	FY20, \$M, %	FY21, \$M, %	FY22, \$M, %	FY23, \$M, %	FY24, \$M, %	FY25, \$M, %	FY26, \$M, %	FY27, \$M, %	FY28-FY32 \$M, %	Total, \$M	Total, %
<b>FEMA Public Assistance</b> 	\$5,397	\$7,394	\$7,394	\$6,709	\$6,709	\$2,173	\$2,173	\$1,279	\$1,279	\$905	\$4,430	\$45,843	55.8%
	11.8%	16.1%	16.1%	14.6%	14.6%	4.7%	4.7%	2.8%	2.8%	2.0%	9.7%		
<b>CDBG</b> 	\$54	\$976	\$4,201	\$4,693	\$4,608	\$3,321	\$1,815	\$331	\$0	\$0	\$0	\$20,000	24.4%
	0.3%	4.9%	21.0%	23.5%	23.0%	16.6%	9.1%	1.7%	0.0%	0.0%	0.0%		
<b>FEMA Individual Assistance</b> 	\$1,437	\$1,437	\$331	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$3,204	3.9%
	44.8%	44.8%	10.3%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%		
<b>Private insurance<sup>1</sup></b> 	\$4,299	\$1,851	\$1,851	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$8,000	9.7%
	53.7%	23.1%	23.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%		
<b>Other federal funding</b> 	\$1,789	\$1,198	\$534	\$421	\$379	\$128	\$128	\$79	\$79	\$58	\$245	\$5,039	6.1%
	35.5%	23.8%	10.6%	8.4%	7.5%	2.5%	2.5%	1.6%	1.6%	1.2%	4.9%		
<b>Total</b>	<b>\$12,976</b>	<b>\$12,855</b>	<b>\$14,311</b>	<b>\$11,823</b>	<b>\$11,696</b>	<b>\$5,623</b>	<b>\$4,117</b>	<b>\$1,689</b>	<b>\$1,358</b>	<b>\$963</b>	<b>\$4,675</b>	<b>\$82,086</b>	<b>100%</b>
<b>Spending as a % of GNP</b>	19.7%	17.8%	18.5%	14.7%	13.9%	6.6%	4.8%	2.0%	1.6%	1.2%	1.1%		
<b>CDBG cost share</b>	\$0	\$736	\$736	\$668	\$668	\$216	\$216	\$127	\$0	\$0	\$0		

Disaster aid by source of funding, \$M



<sup>1</sup> Based on analysis of data from the Office of the Insurance Commissioner of Puerto Rico on already processed payments

The major sources of disaster relief funding are detailed below:

- **FEMA Disaster Relief Fund (DRF):** FEMA provides Individual Assistance to individuals and families who have sustained uncovered losses due to disasters. FEMA also provides Public Assistance for infrastructure projects and other permanent improvements.<sup>7</sup>
- **HUD Community Development Block Grant- Disaster Recovery (CDBG-DR):** Based on a housing recovery plan, HUD provides CDBG-DR funding that can be used for assistance to individuals (e.g., housing repair) and public assistance (e.g., infrastructure development), or by the Government for certain operational costs (e.g., to cover their disaster relief funding match.) The supplemental appropriation included in the Bipartisan Budget Act of 2018 stipulated that about ~\$2 billion be used to repair the Island's electric infrastructure (Public Assistance). The New Fiscal Plan also assumes that \$3.4 billion in CDBG funding will be used to cover cost share for the Commonwealth and its instrumentalities for seven years per statute.
- **Private insurance funding:** Large personal property and casualty losses have been incurred in the aftermath of Hurricane Maria. Early analysis of data from the Office of the Insurance Commissioner of Puerto Rico, adjusted for self-insured and other types of coverage, was used to determine the amount that will be paid out to individuals and businesses for major damages.
- **Other supplemental federal funding:** Additional federal funding has been allocated to various agencies and projects in Puerto Rico following the hurricane. This money is directed at a wide range of recovery efforts, from reconstruction of damaged buildings (for example, funding to repair damage to Job Corps centers in Puerto Rico) to funding for

<sup>7</sup> The New Fiscal Plan does not account for Operations and Administration funding, which only flows to federal agencies. Rather, it looks at funds that are spent for reconstruction on-Island, though those funds could flow to firms that are local or external

health programs and environmental management (for example, NOAA coastal habitat restoration funding).

Disaster roll out for FEMA and CDBG funds have been projected in line with historical spending on other major disaster events, particularly Hurricane Katrina in Louisiana. Rollout was then slowed to reflect specific Puerto Rican conditions; as such, Public Assistance rolls out over the next 15 years. CDBG funds, per statute, are assumed to be spent over the next seven years, and Individual Assistance is assumed to be spent in the immediate aftermath of the storm. For private insurance, the assumption is that the roll out is similar to individual assistance and will largely be spent in the first few post-storm years.

The New Fiscal Plan posits that based on how disaster relief funds are spent, these funds will impact the economy in a number of ways: to build the capital stock of the Island through constructing and repairing buildings or utilities, to directly impact the economy through spurring consumption of goods and services on the Island, or to fund programs and services on the Island. The Plan estimates a different rate of pass-through to the economy for each of these different types of funding as follows:<sup>8</sup>

- A 15.5% pass-through rate is assumed for funding that is used to construct and repair utilities, given the reliance on specialized labor and materials for such projects (e.g., FEMA Category F Public Assistance funding towards constructing public utilities). The rest of this funding flows to the Puerto Rican capital stock and therefore contributes to long-term growth.
- A 23.5% pass-through rate is used for funding that is used to construct and repair residential, commercial, and school buildings given the ability to rely more on local labor and materials (e.g., repair to WIC facilities damaged by the storm). The rest of this funding flows to the Puerto Rican capital stock and therefore contributes to long-term growth.
- A 23.5% pass-through rate is assumed for funding that is directed towards programs and services (e.g., private insurance payments to reimburse personal auto expenditures) as this funding hits the Puerto Rican economy through the labor associated with importing and transporting. This kind of spending does not contribute to the capital stock on the Island, and therefore does not contribute to long-term growth.
- A 100% pass-through rate is assumed for funding that is used directly and in full to replace income or stimulate spending on goods and services originating on the Island (e.g., disaster nutrition assistance). This kind of spending does not contribute to the capital stock on the Island, and therefore does not contribute to long-term growth.

GNP is projected to rebound quickly in FY2019 in large part due to disaster relief funding, and this has a direct positive influence across most revenue categories.

## 4.2 Impact of fiscal measures and structural reforms

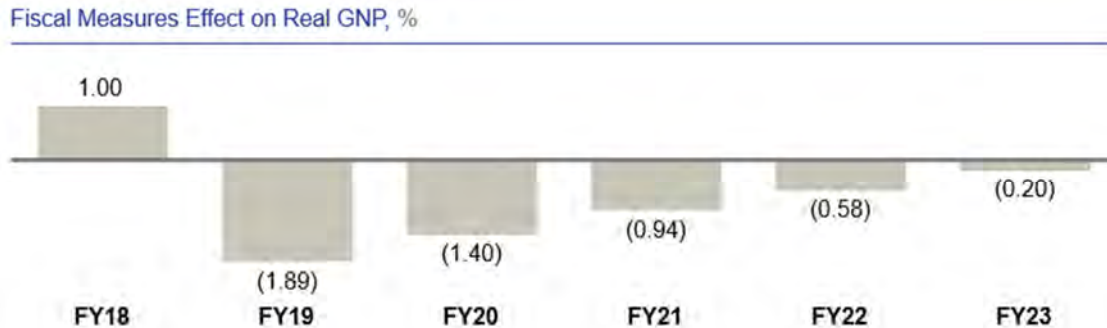
By optimizing revenue collection and reducing government-wide expenditures, **fiscal measures** seek to streamline and transform the Government of Puerto Rico to a size appropriate for its population. Such policy actions will generate a contractionary impact on the economy in the short term, but are necessary to drive fiscal sustainability in the long term. The net effect of these two forces is still significantly positive from a fiscal savings perspective. In addition, the economic contraction estimated from cost-saving measures is limited in the

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<sup>8</sup> Estimated using local contracts for PREPA, residential construction and school construction. These contracts were estimated to have between 10% and 18% pass-through on the economy, respectively, which was then augmented by 5.5% average spend on transportation and logistics on construction projects, which rely on 100% domestic labor. Historical FEMA spending and the percentage of DHS contracts awarded to local Puerto Rican firms supported this figure

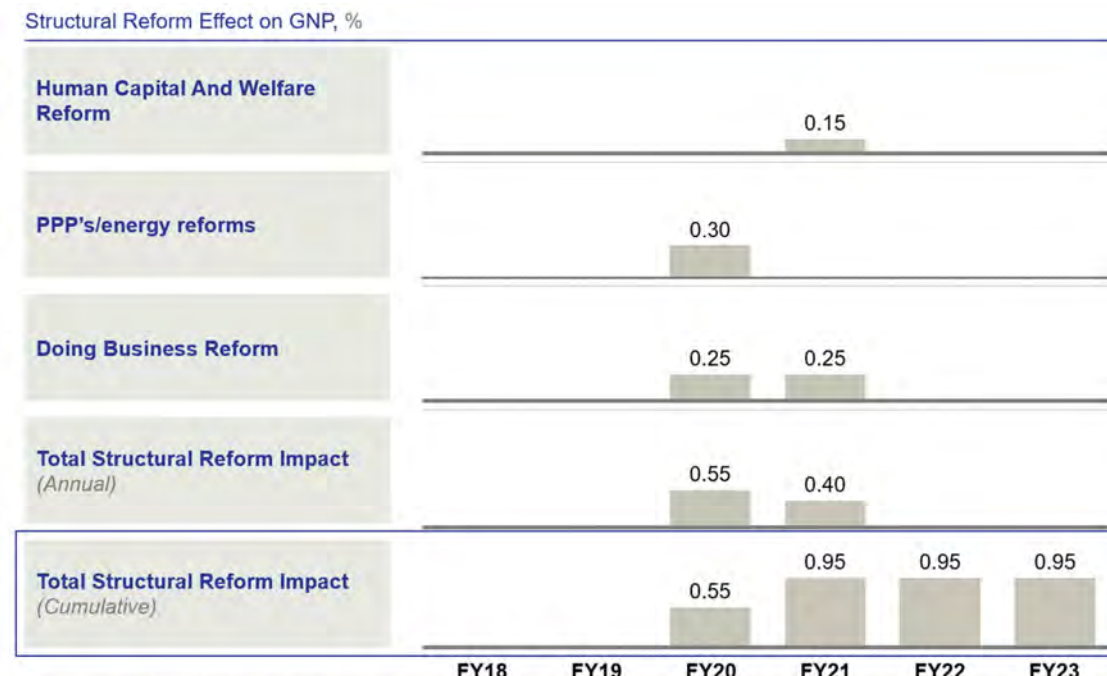
long-term, while such measures are critical for providing long-term financial stability. The macroeconomic impact of the measures is summarized in **Exhibit 9** below.

EXHIBIT 9: MACROECONOMIC IMPACT OF FISCAL MEASURES, INCLUSIVE OF DISASTER RELIEF SPENDING



The timing and impact of **structural reforms** are based on work done by the IMF on similar reforms implemented in Europe (e.g., Spain and Estonia), South America (e.g., Peru and Colombia), among other jurisdictions, utilities reform in Latin America, and broadly accepted metrics for measuring improvement in the World Bank's Ease of Doing Business Rankings. Structural reform benchmarks generally come from nations or jurisdictions without monetary policy options and high informal labor markets, like Puerto Rico. **Labor, energy, and doing business reforms** are projected to increase GNP by **0.95% by FY2023 (Exhibit 10)**. **K-12 education reforms** add an additional 0.01% annual impact beginning in FY2033, resulting in total GNP increase from structural reforms of **1.21% by FY2058**.

EXHIBIT 10: MACROECONOMIC IMPACT OF STRUCTURAL REFORMS



By FY2048, K-12 Education reforms add an additional 0.26% cumulative impact, resulting in 1.21% annual impact on GNP

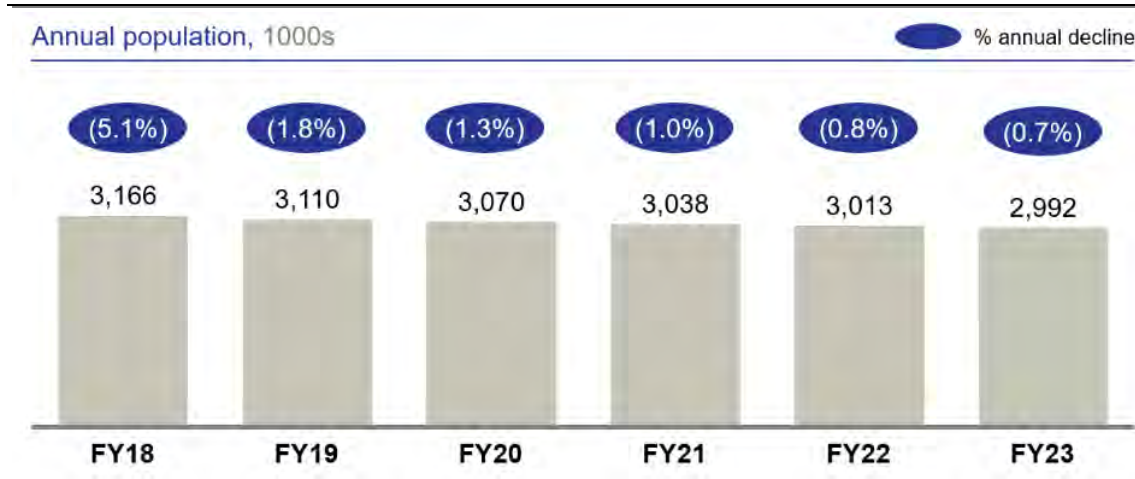
### 4.3 Population projections

In the past five years, Puerto Rico's population has trended downward by 1-2% every year as residents have left to seek opportunities elsewhere and birth rates have declined.<sup>9</sup> Pre-hurricane population forecasts, including the U.S. Census Bureau's official forecast, both projected a worsening population outlook due in large part to Puerto Rico's rapidly aging population. This high average age range results from extremely low age-adjusted birth rates and outmigration of younger people. By 2016, Puerto Rico began to experience negative natural population change (a higher number of deaths than births). Hurricanes Irma and Maria have served to compound the problem, adding an additional massive outflow of people just as natural population decline has set in.

This trend of population decline has accelerated since the storm, as many residents lost houses, jobs and loved ones. While some of these people have returned as the Island rebuilds, population is still projected to decline over the period of the New Fiscal Plan (**Exhibit 11**). Meanwhile, in the long term, population is projected to continue to decline, but at a rate closer to pre-hurricane trends (leveling off at ~0.8-1.2% decline annually by FY2035). One key element of the population projection is the assumption that the low historical rate of immigration into Puerto Rico will continue.

While net migration is a larger driver of population change in the short term, this factor is volatile: in the long run, net migration is projected to return to more balanced trends. Natural population change, however is not guaranteed to rebalance at any point, and births are likely to continue declining, while deaths will rise or stay stable. The result is that under the New Fiscal Plan's population forecast, natural population change begins to outweigh migration as a driver of population change by the mid-2020s.

EXHIBIT 11: PROJECTED POPULATION CHANGE



## Chapter 5. NEW FISCAL PLAN FINANCIAL PROJECTIONS

Before measures and structural reforms ("baseline forecast"), and after incorporation of the COFINA Title III Plan of Adjustment which pledges an annual portion of the SUT to COFINA

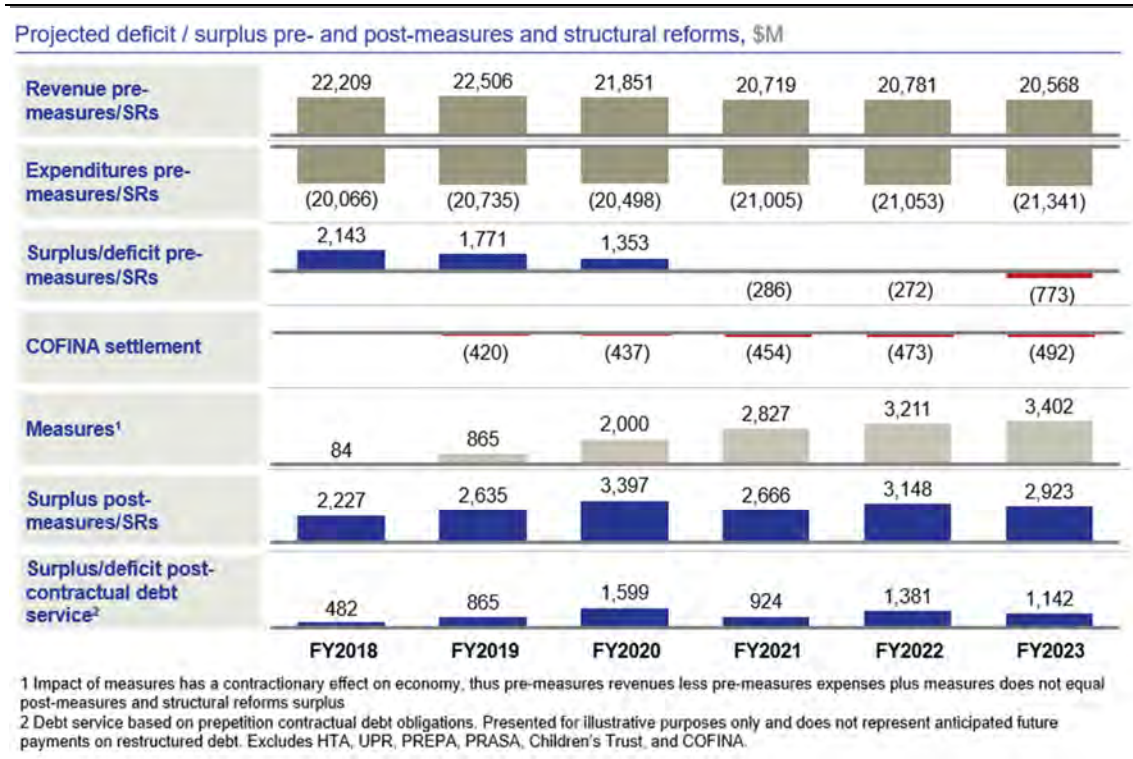
<sup>9</sup> Federal Reserve Bank of St. Louis Economic Research (FRED)

creditors starting at \$420.2 million in FY2019 and increasing to \$992.5 million by FY2041, there is a pre-contractual debt service surplus in FY2018-2020. This surplus is not projected to continue, as federal disaster relief funding slows down, Supplemental Medicaid funding phases out, Act 154 and Non-Resident Withholding revenues decline, and healthcare expenditures rise. Without major Government action, the Island would suffer an annual primary deficit starting in FY2021.

The fiscal measures and structural reforms contained in the New Fiscal Plan help transform the deficit into a surplus for a significant portion of the New Fiscal Plan. Fiscal measures will drive ~\$12.4 billion in savings and extra revenue by FY2023 and structural reforms will drive a cumulative 1.21% increase in growth by FY2058. However, even after fiscal measures and structural reforms and before contractual debt service, there is an annual deficit reflected in the projection starting in FY2034, due to insufficient structural reforms, including restrictive labor policies that prevent higher growth and lack of progress in rolling out Ease of Doing Business reforms. After contractual debt service, the surplus seen in the first six years of the plan drops significantly (**Exhibit 12**) and annual deficits begin in FY27.

Projections for FY2024 onwards are included in the next chapter.

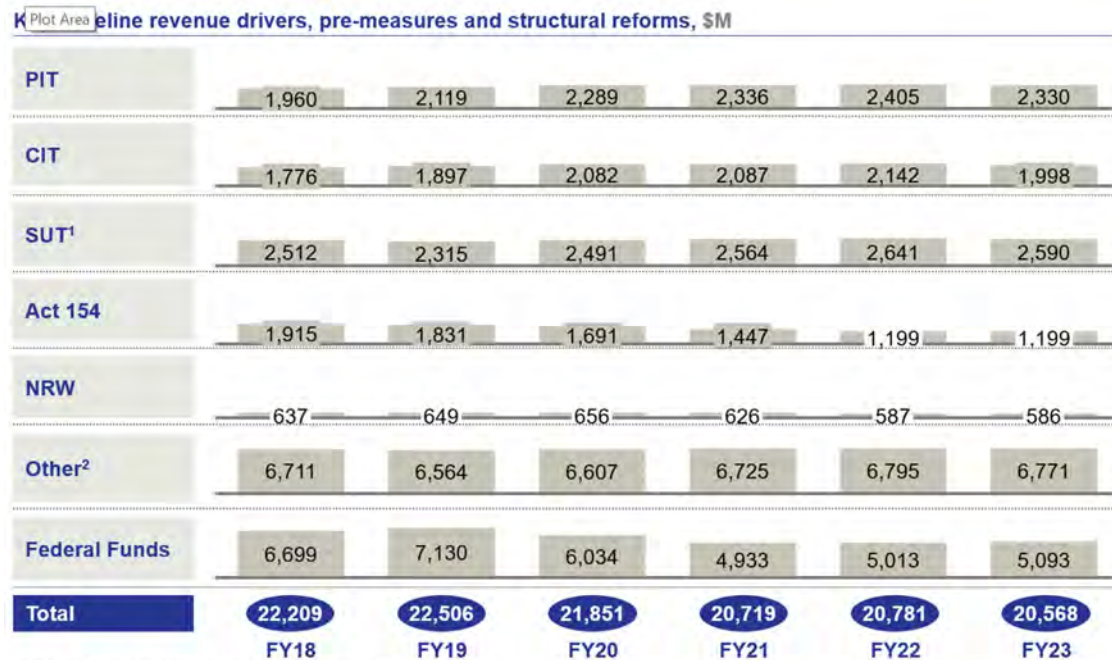
#### EXHIBIT 12: PROJECTED DEFICIT / SURPLUS PRE- AND POST-MEASURES AND STRUCTURAL REFORMS



### 5.1 Baseline revenue forecast

Major revenue streams (**Exhibit 13**) include non-export sector General Fund revenues (including individual, corporate, and sales and use taxes) and export sector revenues (including Act 154 excise taxes paid by multinationals operating on the Island, and Non-Resident Withholdings), as well as federal funding.

EXHIBIT 13: MAJOR REVENUE CATEGORIES PRE-MEASURES AND STRUCTURAL REFORMS



<sup>1</sup> SUT reflects collections after payout of the COFINA settlement

<sup>2</sup> "Other" revenues include cigarette, rum, motor vehicles, alcoholic beverages, and other GF taxes, PREPA loan repayment, CU revenues, third party ASES receipts, other tax/nontax revenues, and SRF-OI revenues for agencies

5.1.1 Non-export sector General Fund revenue projections

In the midst of a decline in economic activity from FY2017 to FY2018, income tax collections proved more resilient than the economy as a whole. A close analysis of the underlying data revealed that tax collections in FY2018 were buoyed by tax receipts from mainland corporations and individuals remitting taxes in Puerto Rico related to recovery-related activities.

**Individual income taxes:** Individual income taxes are highly concentrated, with 78.2% of revenues coming from the 8.7% of returns reporting income above \$60,000<sup>10</sup>. Based on aggregated Hacienda data around new individual taxpayers associated with reconstruction-related industries, and outperformance of revenues relative to GNP, the New Fiscal Plan estimates that \$142 million of these revenues were due to recovery related activity, either from Puerto Rican citizens entering the formal economy or from off-Island workers attached to specific reconstruction projects.

**Corporate income taxes:** There is also concentration in tax receipts among the largest corporations operating in Puerto Rico (e.g., ~29% of corporate income taxes are paid by 20 corporate taxpayers).<sup>11</sup> Based on aggregated data from Hacienda, and outperformance of revenues relative to GNP, the New Fiscal Plan estimates that \$277 million in corporate tax revenues resulted from recovery-related economic activity in FY2018, due to the influx of corporate activity spurred by reconstruction funding, mainland-based firms entering the Island economy, and Puerto Rican firms receiving new business.

<sup>10</sup> Hacienda historical reports as of April 2018

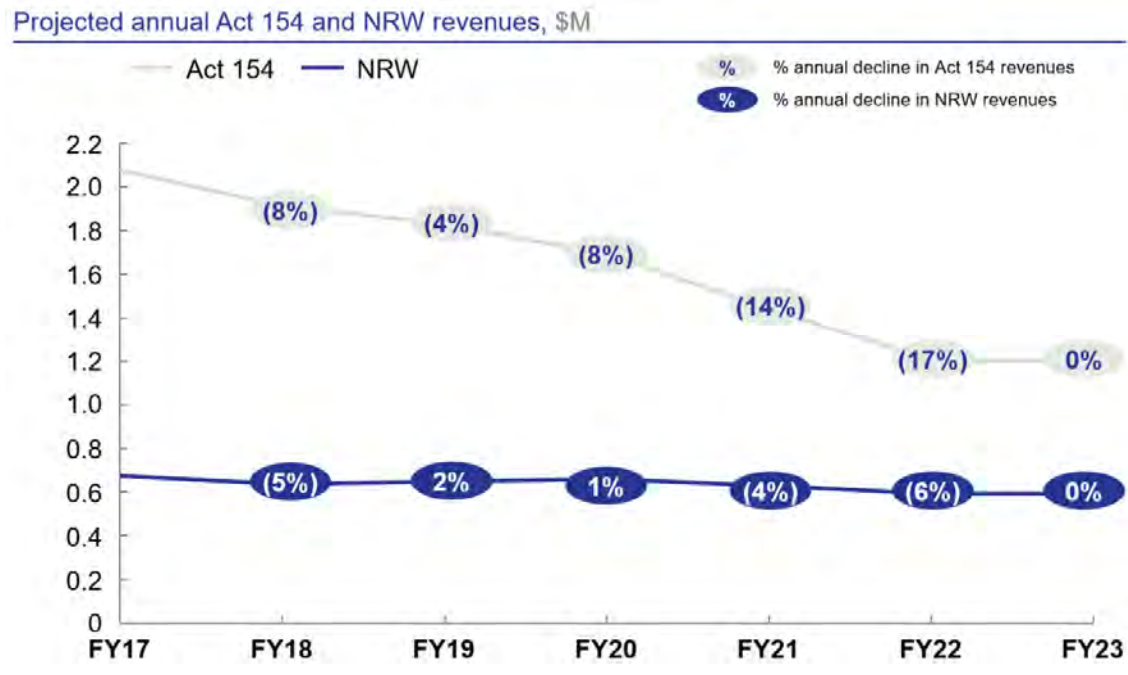
<sup>11</sup> Hacienda historical reports as of April 2018

**Sales and use taxes (SUT):** Like corporate and personal income taxes, SUT revenues were likely boosted by the increased economic activity resulting from the post-disaster reconstruction process (including, through replacement of lost inventory), as well as enhanced compliance by those firms less impacted by the storm. The New Fiscal Plan estimates about a \$59 million FY2018 impact from those recovery related sources. Following the COFINA Title III Plan of Adjustment, a portion of SUT collections will be used to pay the settlement going forward. This portion reaches about \$1 billion annually starting in FY41.

**Other General Fund Revenue (Motor Vehicles, Alcoholic Beverages, Cigarettes):** In FY2018 other General Fund revenues were impacted differently by the economic activity following the storm. Of particular note, there was a surge in motor vehicle revenue of \$62 million, which is estimated to be due to many residents replacing motor vehicles in the wake of the storm.

**Export sector revenue projections:** Act 154 and Non-Resident Withholding (NRW) tax revenues have proven to be less resilient than other types of revenues after the hurricane. Both revenue types are concentrated in a small number of multinational corporations, and the absence of payments from large payers in previous years has had an impact on the overall trendline of these revenues. From FY2017 to FY2023, Hacienda estimates that ~42% of Act 154 and 12% of NRW revenues will erode (**Exhibit 14**) due to the combination of federal tax reform (reducing Puerto Rico's attractiveness as a low tax jurisdiction for multinationals) and hurricane impacts (creating challenges restoring manufacturing operations and exporting).

EXHIBIT 14: PROJECTED ACT 154 AND NON-RESIDENT WITHHOLDING (NRW) REVENUES



### 5.1.2 Medicaid funding

Medicaid costs are typically funded primarily by the Commonwealth, as there is a cap on available federal funding. Typical annual federal funding streams for the Commonwealth are the following, projected based on current law and statutory growth rates:

- **Standard annual federal Medicaid funding.** Although Puerto Rico has a 55% federal matching assistance percentage (FMAP), the amount of annual federal funding received under Section 1108 is capped each year. For FY2018, this funding stream was capped at \$359.2 million, and though the cap grows each year at Medical CPI-U, it does not keep pace with healthcare expenditure growth.<sup>12</sup>
- **Children's Health Insurance Program (CHIP) funding.** CHIP funding is not subject to a federal cap. It also has a higher FMAP at 91.5%, though this federal cost share is projected to decrease in FY2020 with the expiration of the Affordable Care Act's temporary increase. In FY2018, this amount totaled \$172 million.
- Each year, funds are **passed directly through to the Department of Health**. These primary annual disbursements of \$128 million go to Federally Qualified Health Centers (Centros 330, "FQHC") and Medicaid Operations. As a result, baseline federal funding available to cover Mi Salud and CHIP premiums totals only \$403M in FY2018.

In FY2018, the available share of federal funds is much higher due to several sources. Additional federal funding is provided in FY2018 by **remaining Affordable Care Act (ACA)** funds (approximately \$403 million) and supplemental federal funding of \$296 million from the 2017 Omnibus Appropriations Act.

In addition, in February 2018 the Bipartisan Budget Act of 2018 (BBA) allocated a supplemental \$4.8 billion of federal funding to Puerto Rico Medicaid for use between January 2018 and September 2019. Per guidance from the Centers for Medicare and Medicaid Services, this funding is estimated to apply only as a reimbursement for eligible populations (i.e., federally funded Medicaid expenditures). The Puerto Rico Health Insurance Administration (ASES) will spend as much of the allocation as possible before drawing down any remaining ACA funds, which can resume use from September 30, 2019 until expiration in December 31, 2019. Depending on the exact costs incurred in eligible spending buckets, ASES will be able to absorb approximately \$4.4 billion of the allocated funding for core Medicaid expenditures.<sup>13</sup> It will continue to receive its annual CHIP,<sup>14</sup> FQHC, and DOH Medicaid operations funding.

**Exhibit 15** outlines expected Medicaid federal fund receipts. Starting in FY2020, Supplemental funding is projected to phase out. This funding cliff indicates the imperative and urgent need to implement cost-saving measures to reduce long-term Medicaid costs (Medicaid expenditures are discussed in detail in *Section 5.2.2*). All projections are based exclusively on legislation that is currently in force.

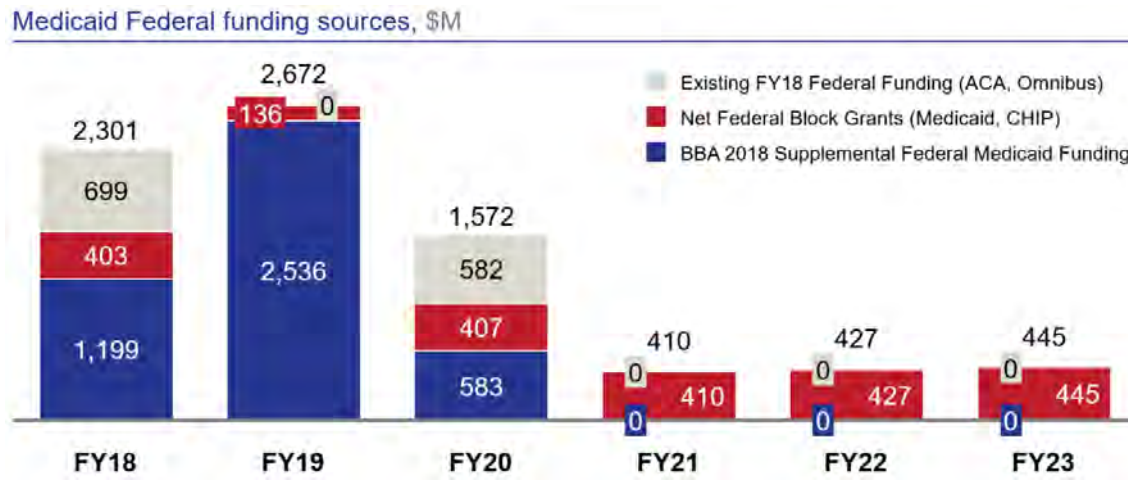
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<sup>12</sup> According to §1108(g) of the Social Security Act., from 2011 to 2016, the cap grows by the medical component of CPI-U as reported by BLS each year. From FY2011-FY2016, this growth averaged 2.9%. This inflation rate differs from the healthcare inflation index for Medicaid and Medicare used elsewhere in this New Fiscal Plan (4.5% to 4.9% from FY2018-FY2023, increasing to 5.1% in FY2038 and subsequently declining to 4.85% by FY2058'). Instead, the medical component of CPI-U includes other factors that lower the inflation rate by approximately 3-5 percentage-points, meaning the increase in the federal funding cap will not keep up with actual increases in expenditures

<sup>13</sup> Current assumption is that only federally funded Medicaid beneficiaries (excluding all CHIP and Commonwealth members) are eligible for reimbursement using BBA funds. These beneficiaries represent approximately 88% of total MCO disbursements, 100% of Platino premiums, all administrative costs, and less any cost-saving measures (described in *Chapter 13*) that reduce reimbursable spend during the timeframe

<sup>14</sup> CHIP funding will continue at 91.5% FMAP until expiration of the ACA enhanced FMAP in September 2019. At that point, FMAP will return to 68.5% pre-ACA level, according to §2101(a) of the Affordable Care Act which amended §2105(b) of the Social Security Act

EXHIBIT 15: MEDICAID EXPECTED FEDERAL FUND RECEIPTS



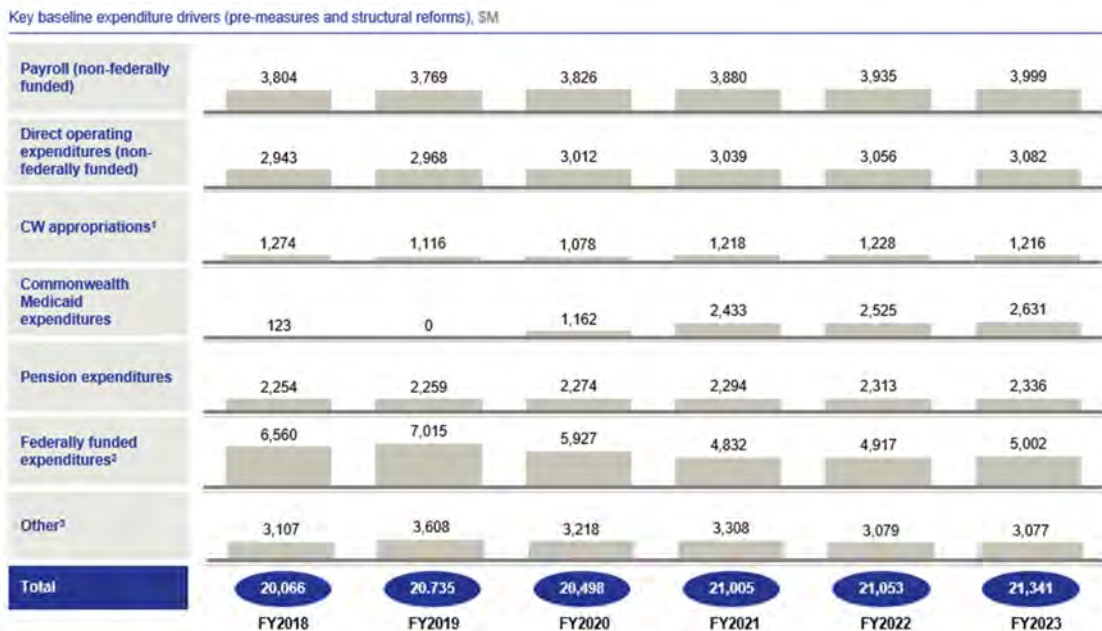
### 5.1.3 Other federal funding

In addition to Medicaid funding, Puerto Rico receives other federal funds on a regular basis. (These are not to be confused with disaster relief funds, which are directly tied to post-storm reconstruction activity.) These funds typically cover both social benefits and operational expenditures. In the New Fiscal Plan, these funds have been modeled based on what types of costs they cover (e.g., benefits or operations) as well as the statutory formula that defines the size of Puerto Rico's allotment. For example, while TANF funds are typically pass-through (e.g., none of these funds go to operational costs), some Title I education funds are used for operational purposes (e.g., teachers' salaries, school supplies for programs for students with special needs, etc.). For the former, federal fund inflows and outflows mirror each other (as benefit needs decline, so do funds). For the latter, though inflows may decline, it does not necessarily mean expenditures decline as well – as expenditures are based on operations, not on benefits formulas. Meanwhile, while Head Start funds are allocated from the Federal Government based on the number of children living in poverty, NAP funds are provided through a block grant that is capped. The former, therefore, should change by population, while the latter should be consistent regardless of population size.

## 5.2 Baseline expenditure forecast

Over the next five years, baseline expenditures are set to increase relative to FY2018 due to inflation and increases in Medicaid costs (**Exhibit 16**).

EXHIBIT 16: MAJOR EXPENDITURE CATEGORIES PRE-MEASURES AND STRUCTURAL REFORMS



<sup>1</sup> Includes appropriations to HTA, UPR, and municipal expenses

<sup>2</sup> Includes federal funds for payroll, direct operating expenditures, Medicaid, and social programs; excludes Independently Forecasted Component Units

<sup>3</sup> Includes appropriations to utilities, disaster recovery cost match, restructuring expenditures, loan to PREPA, maintenance capex, enterprise funds, disbursements to entities outside the fiscal plan, and other non-recurring and recurring costs

5.2.1 Payroll expenditures and non-payroll operating expenditures

**Payroll expenditures:** Consistent granular payroll data continues to be a challenge for the government. FY2018 payroll numbers reflect actual expenditures where available and the certified budget in cases where actual data was not available. FY2019 is assumed to be equal to FY2018 given the Fiscal Plan Compliance Act, which enacted a payroll freeze with the exception of certain agency-specific adjustments. Beginning in FY2020, base payroll is assumed to grow by Puerto Rican inflation. Any reduction to baseline payroll expenditure projections from attrition, absenteeism or workforce reductions will be captured through fiscal measures. Further, whereas the payroll freeze is currently planned to discontinue after FY2019 (which is reflected in the baseline), the extension of this payroll freeze is proposed by the New Fiscal Plan and will therefore be counted as a measure.

**Non-personnel operating expenditures:** Non-personnel operating expenditures are based on the FY2018 budgeted levels. Like payroll expenditures, non-personnel operating expenditures are projected to be frozen at FY2018 levels in FY2019, with costs growing by Puerto Rican inflation beginning in FY2020. For IFCUs, an estimate of actual expenditures is incorporated in FY2018 and projected forward using agency-specific growth metrics through FY2023.

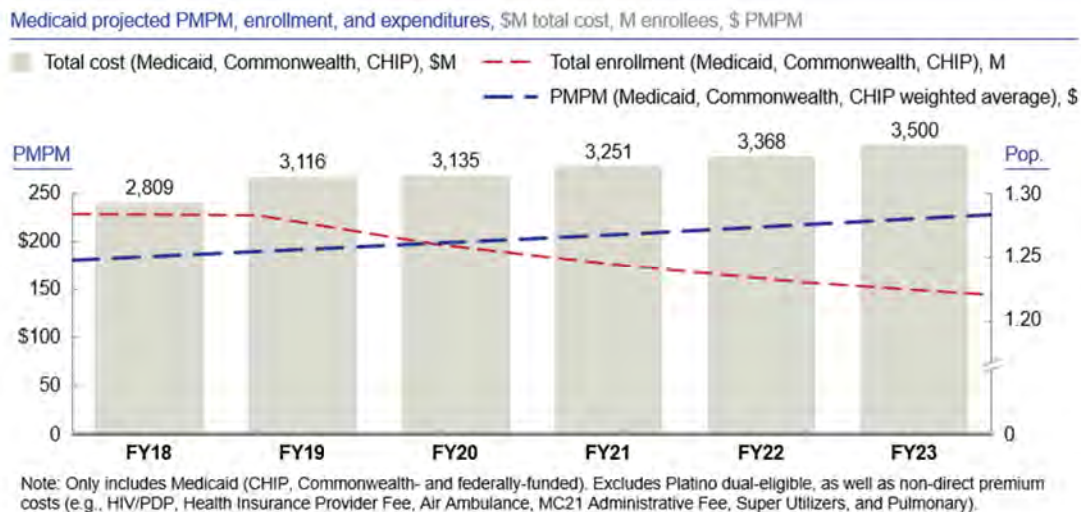
**Utilities:** For FY2018, utility costs are based on the historical cost of government payments for utilities-related costs. For FY2019 onwards utility costs are based on PREPA's and PRASA's FY2019 estimated billings on an agency level. Utility costs are projected to grow by power and water rate increases over the period FY2019-FY2023.

### 5.2.2 Medicaid expenditures

Medicaid costs are projected to reach over \$3.5 billion annually by FY2023 (**Exhibit 17**). These costs are primarily driven by the cost per member per month (PMPM) and the estimated number of people enrolled in Medicaid (federal and Commonwealth), CHIP, and Platino dual eligible programs—which altogether amount to roughly \$3.36B of the total. Other categories also include health-related expenditures (e.g., HIV and pulmonary programs) and program administration.

**PMPM costs** are projected to grow at 4.5% p.a. in FY2019 and increase to an annual growth rate of 4.9% in FY2023. This rate tracks pre-hurricane growth in Puerto Rico after the Island switched to a fully managed care model in 2015. As the overall population of Puerto Rico decreases, the Mi Salud population will decline concurrently, but will likely lag overall outmigration trends by one year due to the time needed for individuals to switch to a new plan once they have left the Island. In the long term, costs increase according to an age-mix adjusted PMPM growth rate (see *Section 6.I*).

EXHIBIT 17: PROJECTIONS FOR MI SALUD BASELINE PMPM AND ENROLLMENT (NOT INCLUDING PLATINO)



**Other Commonwealth expenditures**, which include HIV/PDP, Health Insurance Provider Fee, Air Ambulance, MC21 administrative fee, Super Utilizers, and Pulmonary, among others, are projected to grow at the rate of Puerto Rico inflation. The Health Insurance Provider fee also must be paid per federal law unless Congress imposes a moratorium. It is calculated each year by the Federal Government, but estimated to be 1.80% of premiums.<sup>15</sup>

Expenditures for the Platino dual-eligible program were estimated using a consistent \$10 PMPM over FY2018-FY2023, representing payment for wrap-around services supplementing main Medicare coverage. Enrollment is projected to be affected similarly to Medicaid

<sup>15</sup> See sec 4003 of FOURTH CONTINUING APPROPRIATIONS FOR FISCAL YEAR 2018 at <https://www.congress.gov/115/plaws/publ120/PLAW-115publ120.pdf> See sec 4003. Growth estimated by Milliman Consulting and Actuary based on 2016 estimated percent of premiums calculated as the total fee due by ASES contracted MCOs divided by the total capitation paid to MCOs for the GHP program.

enrollment, though with less fluctuation in actual proportion of population enrolled.<sup>16</sup> Platino costs are expected to total \$31 million in FY2018 and decline slightly to \$27 million by FY2023.

### *5.2.3 Other expenditures*

**Appropriations:** Baseline municipal appropriations are projected to remain constant at ~\$220 million from FY2018-FY2023, with the exception of a *one-time* allotment to municipalities as a result of Hurricanes Irma and Maria, which took place in FY2018 for the amount of \$78 million. This was allocated on the same basis as the existing municipality subsidies. The University of Puerto Rico appropriation baseline is \$678 million in FY2018 and remains ~\$717 million from FY2019-FY2023.

**Pension costs:** Projections rely on demographic estimations for Employees' Retirement System (ERS), Teachers' Retirement System (TRS), and Judicial Retirement System (JRS) populations and benefit obligations, and include updated data and actuarial projections for regular TRS and JRS benefits (extrapolated to update estimates for ERS). From FY2018-FY2023, costs are projected to grow slowly but remain approximately \$2.3 billion.<sup>17</sup> Since FY2018 ERS pension benefits have been paid on a pay-as-you-go basis, given that the majority of the liquid assets in the retirement system have been depleted.

**Capital expenditures:** Centrally funded maintenance and capital expenditures of the Commonwealth (excluding PREPA, PRASA, HTA self-funded capex and one-time transfers) are expected to grow by inflation from a baseline of ~\$400 million in FY2018. Of this, an ~\$125 million will be appropriated annually to HTA and UPR, with the remaining ~\$275 million for use by the Commonwealth. HTA's capital expenditure funds will be used to support reconstruction, maintenance, traffic reduction, completion of the strategic network, and P3-related expenditures. UPR's capital expenditure funds will support, among other projects, Phase III of the large Molecular Sciences building, building restoration at Rio Piedras, and the development of a major campus building at Mayagüez.

**Cost share of disaster relief funding:** Federal funds for public assistance typically require a local match from the entity receiving them (anywhere from 10-25% of funds). In the case of Puerto Rico, the New Fiscal Plan projects that the Commonwealth will need to cover an estimated 10% of federal public assistance funds, amounting to \$1.9 billion from FY2018-FY2032. The instrumentalities will shoulder a further \$2.2 billion in total cost match expenditures during the same period. However, Commonwealth and instrumentalities cost match expenditures are projected to be covered by CDBG funds through FY2025, which amounts to \$3.4 billion (almost 17% of total CDBG funding). **PROMESA related costs:** Commonwealth PROMESA-related expenditures are projected to be \$1.5 billion for FY2018 to FY2023, comprised of professional fees (approximately \$1.1 billion over six years) and funding for the Oversight Board (\$430 million over six years). The estimate for professional fees was developed, in conjunction with the Government, by analyzing FY2018 run-rate billings based on available information and soliciting input from certain professionals. Fees were benchmarked versus comparable restructuring situations that yield an average professional-fee-to-funded-debt ratio of 1.89% relative to 1.68% projected for the Commonwealth (**Exhibit 18**).

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<sup>16</sup> Projected based on a smaller observed spike in actual enrollment from pre- to post-Maria relative to Medicaid spike

<sup>17</sup> Projections for pension expenditures are provided by Pension Trustee Advisors (PTA) calculations

EXHIBIT 18: PROJECTED PROFESSIONAL FEES RELATIVE TO OTHER MAJOR RESTRUCTURINGS

Professional fees for restructuring				
	Date filed	Outstanding debt, USD	Total fees and expenses, USD	Fees to funded debt, %
City of Detroit, Michigan	Jul. 2013	\$20,000,000,000	\$177,910,000	0.89%
Residential Capital, LLC	May-12	\$15,000,000,000	\$409,321,308	2.73%
Sabine Oil & Gas Corp.	Jul. 2015	\$2,800,000,000	\$78,553,223	2.81%
Caesars Entertainment Operating Company	Jan. 2015	\$18,000,000,000	\$258,278,005	1.43%
Lehman Brothers Holdings Inc.	Sep. 2008	\$613,000,000,000	\$956,957,469	0.16%
Lyondell Chemical Company	Jan. 2009	\$22,000,000,000	\$205,932,292	0.94%
American Airlines	Nov. 2011	\$11,000,000,000	\$391,637,858	3.56%
Washington Mutual, Inc.	Sep. 2008	\$8,000,000,000	\$271,085,213	3.39%
Edison Mission Energy	Dec. 2012	\$5,000,000,000	\$96,244,628	1.92%
Energy Future Holdings Corp.	Apr. 2014	\$40,000,000,000	\$450,110,233	1.13%
Puerto Rico	2017	\$64,000,000,000	\$1,075,026,215	1.68%

Summary Statistics

Avg.	1.89%
Max	3.56%
Min	0.16%
Med	1.68%

Puerto Rico Involves added complexity as the largest public sector restructuring in the history of the United States



Puerto Rico involves added complexity as the largest public sector restructuring in the history of the United States

**Emergency reserve:** The Commonwealth must establish an emergency reserve of \$1.3 billion, or ~2.0% of FY2018 GNP, by reserving \$130 million per year for 10 years starting in FY2019. The methodology supporting this reserve is informed by guidance provided to other Caribbean islands by the International Monetary Fund in defining an adequate emergency reserve (2-4% of GNP, accumulated at ½% per year).<sup>18</sup> Restrictions on the use of this fund must ensure that it is a true emergency reserve.

## Chapter 6. LONG-TERM PROJECTIONS AND DEBT SUSTAINABILITY ANALYSIS (DSA)

While the New Fiscal Plan emphasizes actions to be taken in the period from FY2019-FY2023, the Oversight Board's ultimate goal is to put Puerto Rico on a path towards long-term fiscal balance. The Government's existing bonded debt also is long-term, with final maturities on some credits extending out 40 years from today to FY2058. Accordingly, long-term projections are an important component in evaluating the New Fiscal Plan's implementation and in the resulting Debt Sustainability Analysis (DSA). The outcome of the DSA pertains to traditional debt only, and not to other types such as contingent or no-default debt. Given large swings in debt sustainability shown in the sensitivity analysis, the amount of sustainable debt should be made contingent on several factors. Finally, the debt sustainability analysis should account for new facts when available and errors when proven.

<sup>18</sup> IMF Bahamas Article IV report published March 22, 2018

## 6.1 Macroeconomic, revenue and expenditure projections

Most macroeconomic trends are projected to be variable throughout the hurricane recovery period, with a bounce back in economic activity in FY2019 and FY2020 that then steadily declines as disaster relief funding drops off considerably and structural reform growth rates are muted. Real growth is 0.20% from FY2044 onward. Population is estimated to steadily decline at an average rate of 1.12% from 2019-2023, reaching a ~1% annual decline in the long term. Inflation settles at a run-rate of 2.00% as it is expected to converge to mainland forecasts.

Most revenues are projected to grow with nominal GNP in the long term<sup>19</sup>. This includes SUT, corporate income tax, personal income tax, non-resident withholding not paid by Act 154 entities and most General Fund revenues. Exceptions include:

- **Alcoholic beverages and cigarette-related tax** revenues, which are expected to grow by inflation and population. This assumption is supported both by relatively constant alcohol consumption in growing economies along with long-term decline in cigarette consumption both in Puerto Rico and in the U.S. mainland.
- **Rum excise on off-shore shipments**, is expected to grow by U.S. mainland population and is partially driven by the statutory waterfall by which rum excise taxes are paid into the General Fund.
- **Non-resident withholding (NRW) and Act 154 revenues**, which will face declines due to U.S. tax reform, supply chain diversification, and patent expirations. These risks are reflected by a gradual decline in revenues (between \$100-200 million per year) that leads to a steady state of \$859 million in annual Act 154 revenues beginning in FY2031. NRW payments made by Act 154 payers are projected to follow a similar trajectory. After reaching steady state in FY2031, both remain flat at ~45% and ~55% of their FY2018 levels, respectively. NRW revenues not related to Act 154 payers continue to grow with nominal GNP.

Federal funds grow based on historical and statutory appropriations. **Medicaid** receives the most significant federal funding. Standard Medicaid matching funds grow by the medical services component of CPI-U, CHIP funding grows proportional to CHIP cost growth, Municipal intra-governmental transfers remain constant, and prescription drug rebates grow proportionally to healthcare costs and population.

Just as most revenues grow by GNP, **payroll and non-payroll operating expenditures grow by standard inflation**,<sup>20</sup> as do baseline appropriations and utilities after FY2023. Exceptions include:

- **Medicaid premiums**, which grow at a faster pace than standard inflation, and instead grow by healthcare inflation and population growth. After FY2023, the age-mix-adjusted PMPM inflation rate is expected to increase slightly from 4.90% in FY2024 to 5.10% in FY2038, then to fall to 4.85% by FY2058. This projection is inclusive of two countervailing factors. First, on average, cost per person will increase as the population on Medicaid shifts into older age brackets (i.e., there will be people within the 55-65 age bracket on Medicaid). Second, general cost efficiency spillovers from the U.S. mainland are expected to exert downward pressure on PMPMs. Non-premium costs, such as administrative and “other” Medicaid costs grow by standard inflation in the long-term.

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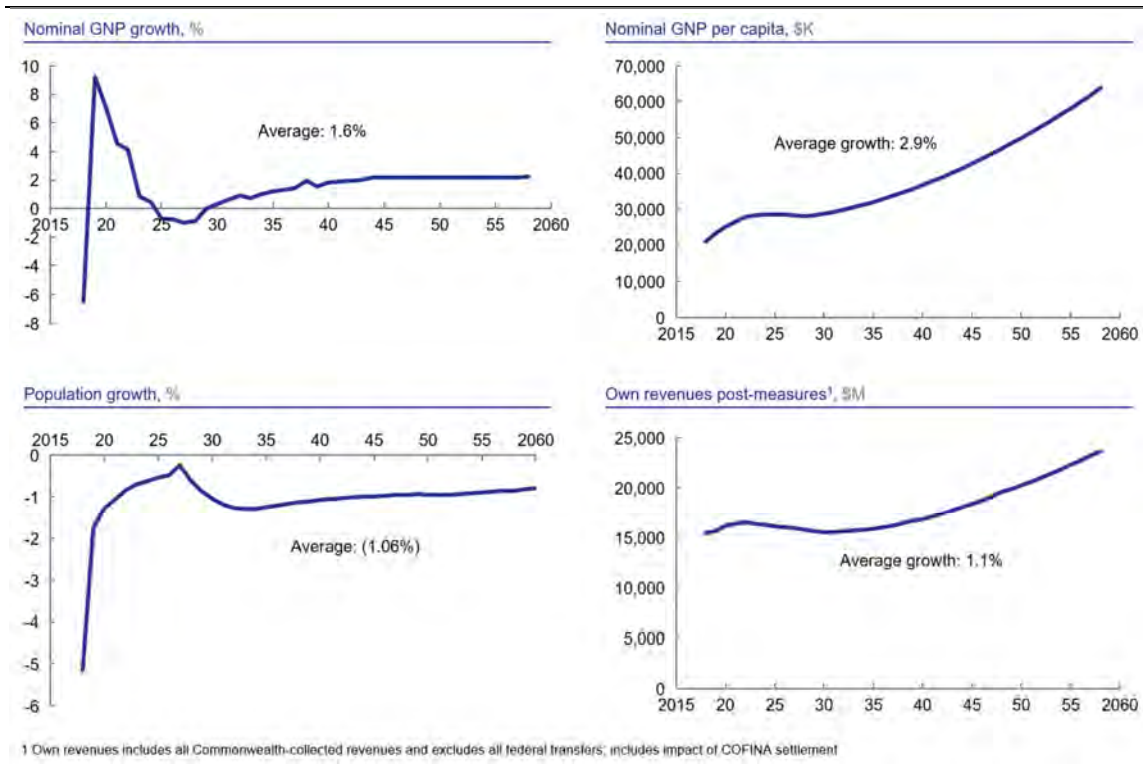
<sup>19</sup> This methodology is consistent with general IMF forecasting approaches and is intended to capture the overall change in consumption, investment and production within the economy

<sup>20</sup> Due to constraints on adding additional costs beyond inflation-related adjustments

- **Capital expenditures**, which are anticipated to rise to 1.9% of GNP (in line with the mainland average) by FY2038 increasing the annual Commonwealth average to \$824 million, as Puerto Rico must sustain a higher level of maintenance and rely on its own funding for capital investments (rather than disaster relief funding). **Cost match for disaster-related federal funding**, which increases to an average of ~\$40 million from FY2026 to FY2032, as the Commonwealth pays the entirety of the cost match during that period. The Commonwealth is not responsible for the portion of funds allocated to instrumentalities (e.g., PREPA, PRASA, HTA).
- **Fiscal measures**, which grow by their relevant macroeconomic indicator (e.g., revenues by nominal Puerto Rican GNP, expenditures by Puerto Rican inflation). Unfortunately, due to the lack of deep **structural reforms**, while growth reaches a positive trendline in the long-term forecast (e.g., 0.2% real growth from FY44 onward), annual deficits begin in FY2034 and continue until FY2058.

The long-term macroeconomic projections show trends as below (**Exhibits 19 and 20**).

EXHIBIT 19: 40-YEAR FINANCIAL PROJECTIONS



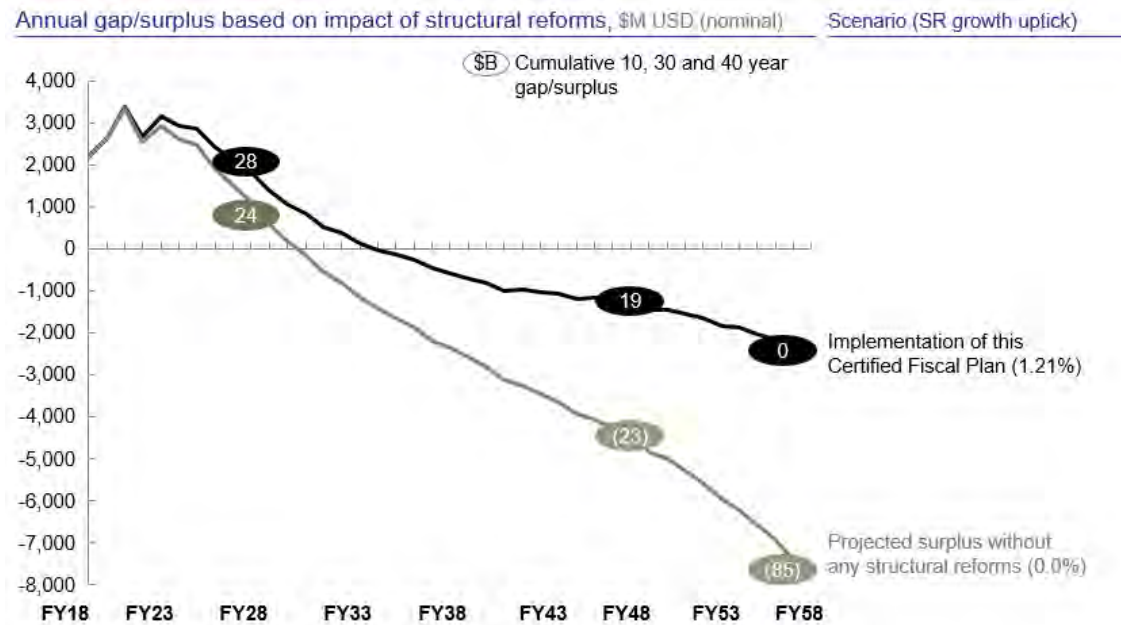
## EXHIBIT 20: LONG-TERM FISCAL PLAN PROJECTIONS POST-MEASURES AND STRUCTURAL REFORMS

Financial projection detail post-measures and structural reforms, units as labeled

Projection	FY2023	FY2030	FY2035	FY2040	FY2045	FY2050	FY2055	FY2058
Population, #	2,992,205	2,864,265	2,689,901	2,540,266	2,414,286	2,301,681	2,197,371	2,141,450
Population growth rate, %	(0.7%)	(1.1%)	(1.2%)	(1.1%)	(1.0%)	(0.9%)	(0.9%)	(0.8%)
Real GNP growth, %	(0.7%)	(1.2%)	(0.4%)	(0.2%)	0.2%	0.2%	0.2%	0.2%
Nominal GNP, \$M	84,725	82,488	86,178	93,320	103,180	114,929	127,926	136,561
Nominal GNP per capita, \$	28,317	28,801	32,039	36,738	42,739	49,935	58,221	63,774
Nominal GNP per capita growth, %	1.6%	1.4%	2.4%	2.9%	3.2%	3.1%	3.1%	3.1%
Inflation, %	1.5%	1.5%	1.6%	2.0%	2.0%	2.0%	2.0%	2.0%
Disaster funding, \$M	5,623	953	-	-	-	-	-	-
Revenues, \$M	21,430	21,269	22,044	23,603	25,822	28,437	31,355	33,296
Commonwealth revenues	16,336	15,587	15,919	16,901	18,433	20,276	22,332	23,704
Federal transfers	5,093	5,682	6,126	6,702	7,389	8,161	9,023	9,592
Expenditures, \$M	(18,506)	(20,445)	(22,188)	(24,413)	(27,033)	(29,883)	(33,380)	(35,801)
Commonwealth-funded expenditures	(13,505)	(14,840)	(16,104)	(17,714)	(19,608)	(21,643)	(24,229)	(26,051)
Federally-funded expenditures	(5,002)	(5,604)	(6,084)	(6,699)	(7,425)	(8,240)	(9,151)	(9,751)
Gap/surplus, \$M	2,923	824	(144)	(810)	(1,211)	(1,446)	(2,025)	(2,505)
Contractual debt service payments <sup>1</sup>	(1,782)	(1,904)	(1,653)	(1,049)	(163)	(50)	(233)	(236)
Net gap / surplus, \$M	1,142	(1,080)	(1,797)	(1,859)	(1,374)	(1,496)	(2,257)	(2,741)

<sup>1</sup> Debt service based on prepetition contractual debt obligations. Presented for illustrative purposes only and does not represent anticipated future payments on restructured debt. Includes GO, PBA, CCDA, PRIFA, PFC, ERS, PRIDCO. The New Fiscal Plan does not assume any predetermined outcome of ongoing litigation with respect to GO bonds.

## EXHIBIT 21: ANNUAL GAP/SURPLUS BASED ON IMPACT OF STRUCTURAL REFORMS



The New Fiscal Plan forecasted surpluses are primarily revenue driven in the short term, with accelerating forecasted expenditure growth producing out-year deficits. Short-term surpluses are driven by fiscal measures and structural reforms, accompanied by federal funding for Medicaid and disaster relief and enhanced revenue actuals (**Exhibit 21**). Long-term deficits are driven by healthcare costs that outpace GNP growth, lack of robust structural reforms, phase out of disaster relief funding, and declining Act 154 revenues.

**The necessity of fiscal balance in the long term.** While the New Fiscal Plan projects deficits as from FY2034 onward, the Government will be required to take additional measures that go beyond the five-year framework of this New Fiscal Plan as – per the Constitution— the Government must operate within a framework of fiscal balance. Accordingly, what follows are a set of options future governments can consider to obtain fiscal balance in the out-years. Some of these reforms—which would reduce deficits and therefore make funds available for a variety of potential uses, including reinvestment in the people of Puerto Rico—have been proposed by the Oversight Board, but have not been adopted and the Oversight Board cannot implement them on its own.

- **Labor reform**, generating an additional 0.50% GNP growth over two years, by repealing Law 80, reducing paid leave, and eliminating the Christmas Bonus. Key reforms could require incentives, such as wage subsidies for low-income workers and training programs to address identifiable skills gaps. The reform would increase the 40-year surplus by \$32 billion if implemented after 10 years (FY2028) and by \$14 billion if implementation lags by 20 years (FY2038).
- **Ease of Doing Business reform**, generating an additional 0.15% GNP growth, based on instituting Trading Across Borders reform to improve customs processes and congestion and on repealing restrictive laws (e.g., Laws 21 and 75 dictating terms for terminating commercial supplier relationships). The 40-year surplus would increase by \$9 billion when implemented after 10 years (FY2028) and by \$4 billion if implementation lags by 20 years (FY2038).
- **Overhaul of the tax system of Puerto Rico** to stimulate growth, requiring short-term investment (lower revenues in short-term) for long-term growth benefits up to 0.5% spread over 5 years. The reform would increase the 40-year surplus by \$29 billion when implemented after 10 years (FY2028) and by \$13 billion if implementation lags by 20 years (FY2038).
- **Imposing a cap on total healthcare expenditure growth** at 2% to 2.5% above standard inflation, resulting in savings between \$1 billion and \$2 billion by FY2058 depending on whether it is implemented in 10 years (FY2028) or 20 years (FY2038).
- **Securing additional permanent federal funding for Medicaid** similar to historical federal incremental contributions (e.g., annual funding of \$500M growing by inflation) would increase the 40-year surplus by \$29 billion if implemented after 10 years (FY2028) and by \$21 billion if implemented after 20 years (FY2038).

**Risks to the long-term projections in the New Fiscal Plan.** While the New Fiscal Plan projects that ~\$30 billion surplus will be generated through FY2033, there are several variables that have a material impact on the long-term financial projections in the New Fiscal Plan. For example, revenues could be compromised through lower growth generated by structural reforms, and both revenues and expenditures could be impacted by demographic shifts not yet seen on the Island. Moreover, in the areas of government expenditures:

- **Changes in Medicaid costs and specifically in the PMPM** costs could affect the long-term projections of the New Fiscal Plan. Assuming a PMPM growth rate of 7.1% from FY2019 to FY2023, falling to 4.6% in the long term (instead of the current projection where healthcare inflation varies between 4.85% and 5.1% between FY2023 and FY2058) could decrease the surplus by ~\$35 billion.
- **Implementation risk of agency efficiency measures** also exists. For example, if only 50% of the projected run rate agency efficiency measures are achieved, the 40-year

surplus could decrease by \$40 billion<sup>21</sup>. Similarly, if only 75% of the projected run rate agency efficiency measures are achieved, the 40-year surplus would decrease by \$20 billion<sup>22</sup>.

**Managing deficits with early year surpluses.** The New Fiscal Plan projects a surplus—generated by structural reforms, fiscal measures, and increased federal funding—through FY2033, and deficits thereafter. In addition to implementing the structural reforms identified above, these would increase the Island’s competitiveness, improve its economy, and produce surpluses. If and when there are deficits in any year, there are also a number of strategies that the Oversight Board and Government can pursue to manage those deficits with early year surpluses. Options include prepaying future legacy obligations, such as debt or pensions; buying back existing debt; and using new money debt to finance capital expenditures.

## 6.2 Debt Sustainability Analysis (DSA)

The DSA is intended to provide a framework for assessing the long-term capacity of the Government to pay debt service on its bonded debt. Debt levels post-restructuring need to be sustainable over the long-term and consistent with both a minimal risk of default on the restructured debt and a recovery of market access for future new money capital borrowings for ongoing infrastructure investment. The analysis begins with the New Fiscal Plan and is then informed by the debt sustained by the most appropriate peer group against which to benchmark Puerto Rico. The DSA then applies rating agency metrics for that benchmark group to Puerto Rico to arrive at an assessment of what debt levels are sustainable in light of long-term projections and the peer metrics. Net tax-supported debt is defined as debt payable from statewide taxes and other general resources, net of obligations that are self-supporting from pledged sources other than state taxes or operating resources (such as utility or local government revenues). Puerto Rico has approximately \$45 billion of net tax-supported debt comprised of GO, PBA, COFINA, PRIFA, HTA, CCDA, ERS, PFC, and UPR. Net of the COFINA debt that is now the subject of a separate COFINA Fiscal Plan and will be restructured pursuant to a COFINA Title III Plan of Adjustment, Puerto Rico’s other net tax-supported debt outstanding totals approximately \$27 billion.

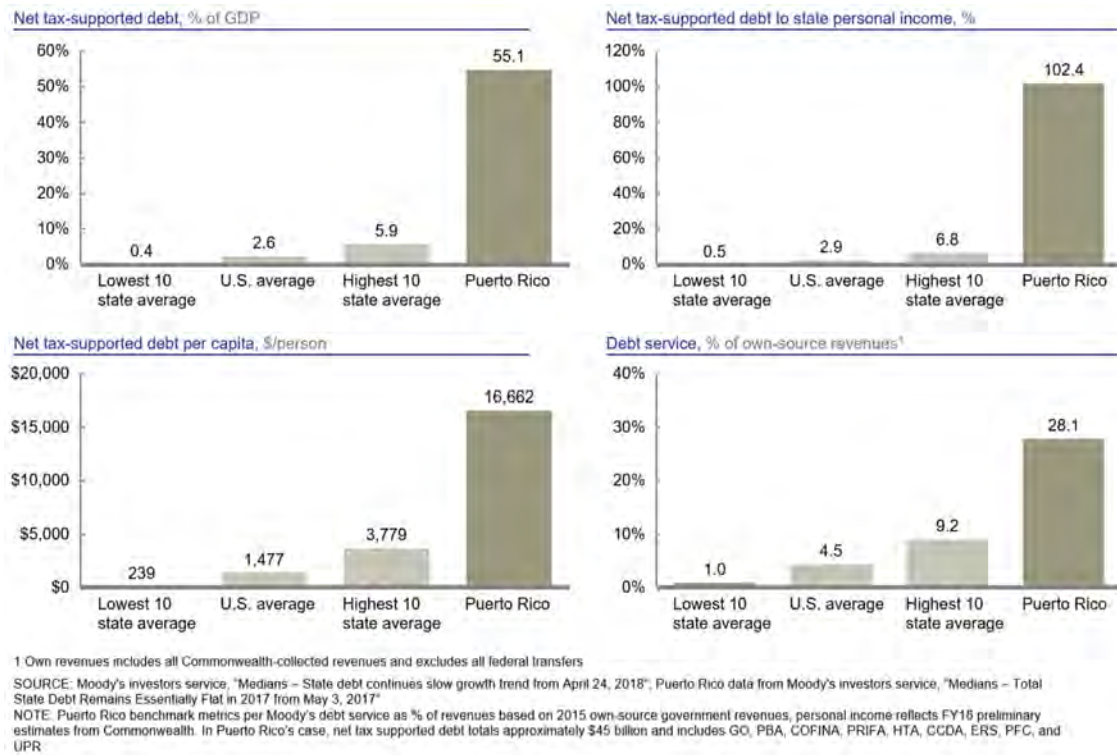
**U.S. states as peer comparables.** For many reasons, U.S. states are the most appropriate comparison group to use in benchmarking sustainable debt levels for Puerto Rico. Like U.S. states, Puerto Rico does not control its own currency, has no access to IMF restructuring support programs or similar international sovereign relief funding packages, and traditionally has been reliant on access to the same long-term municipal bond market used by the U.S. states to finance their capital needs. Puerto Rico’s bonds also are rated by the same rating agency analyst groups that assign ratings to U.S. states, not by foreign sovereign bond rating analysts. For these and other reasons, Puerto Rico has more similarities to U.S. states than to sovereign nations. By virtually any measure tracked by the rating agencies, Puerto Rico’s existing debt levels are clear outliers relative to these U.S. state peers (**Exhibit 22**).

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<sup>21</sup> Includes Special Revenue Fund deficit measure

<sup>22</sup> Ibid.

EXHIBIT 22: US STATES AS COMPARABLES

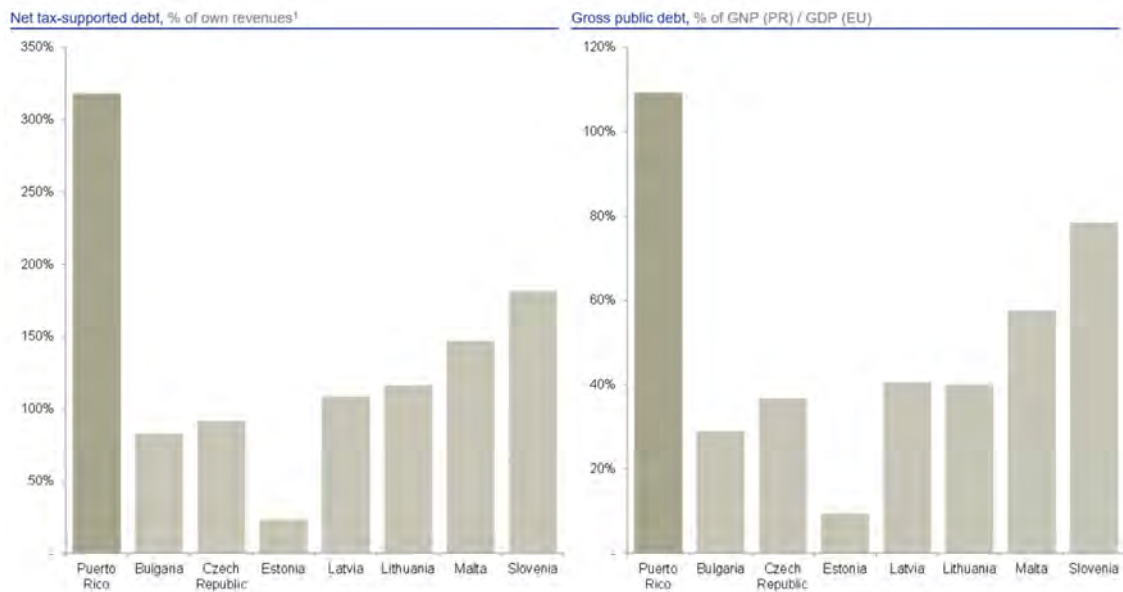


While some observers note that Puerto Rico residents do not pay federal income taxes, they do pay Social Security and Medicare taxes, and the low per capita income levels would place most Puerto Ricans in a tax bracket where they would otherwise pay little or no federal income tax. Meanwhile, federal reimbursement levels provided to Puerto Rico for the largest Commonwealth spending programs (including Medicaid and transportation) are capped at levels well below the FMAP and federal highway reimbursement levels provided to comparably sized and wealthier states. Puerto Rico's residents pay graduated income taxes to Puerto Rico at brackets comparable to the federal income tax rates, thereby providing the funds needed to provide services to the Puerto Rico resident population, which is far poorer than the population of any U.S. state. Yet Puerto Rico receives less federal support. The most recent U.S. Census Bureau estimate of per capita income in Puerto Rico was \$11,688, 67.9% below the lowest U.S. state and 76.8% below average U.S. state 2017 per capita income.<sup>23</sup>

In general, foreign sovereigns are not the most appropriate comparable to use in determining Puerto Rico's debt sustainability levels given the reasons described above, but of foreign sovereigns, smaller European Union countries offer the closest comparator. Like Puerto Rico, these EU nations also lack their own currency and monetary policy levers, although they can and do access IMF financial support. Puerto Rico's current debt levels are also an outlier when compared to these EU sovereigns (**Exhibit 23**).

<sup>23</sup> U.S. Bureau of Economic Analysis in the March 22, 2018 release

## EXHIBIT 23: EU SOVEREIGNS AS COMPARABLES



<sup>1</sup> Own revenues includes all Commonwealth-collected revenues and excludes all federal transfers

SOURCE: Puerto Rico data from Commonwealth sources and Board Economist, European Commission Debt Sustainability Monitor 2017 Institutional Paper 071, published January 2018 and data from the World Bank at <https://data.worldbank.org/>

**Metrics for debt sustainability.** Viewing U.S. states as the most comparable group for benchmarking Puerto Rico, the DSA uses the debt ratio metrics in the April 24, 2018 Moody's Investors Service ("Moody's") report "States – U.S. Medians – State debt continues slow growth trend" and the "Fixed Costs" ratio metrics in Exhibit 20 of the August 27, 2018 Moody's report "States – U.S. Medians – Adjusted net pension liabilities spike in advance of moderate declines" to develop a range of levels for sustainable debt capacity, including maximum annual debt service levels for Puerto Rico on its restructured existing debt. The key debt ratios and "Fixed Cost" ratios for the ten lowest indebted states, the ten highest indebted states, and the mean for all U.S. states are shown below (**Exhibit 24**).

## EXHIBIT 24: KEY DEBT RATIOS FOR TEN HIGHEST INDEBTED STATES

Net tax-supported debt % of GDP <sup>1</sup>		Net tax-supported debt to state personal income, % <sup>1</sup>		Net tax-supported debt per capita, \$ <sup>1</sup>		Debt Service % of own-source revenues <sup>2</sup>		Fixed Costs % of own-source revenues <sup>2</sup>	
Low 10	0.4%	Low 10	0.5%	Low 10	\$239	Low 10	1.0%	Low 10	3.6%
Mean	2.6%	Mean	2.9%	Mean	\$1,477	MEAN	4.5%	MEAN	10.3%
Top 10	5.9%	Top 10	6.8%	Top 10	\$3,779	Top 10	9.2%	Top 10	20.9%
1 Connecticut	9.0%	1 Hawaii	10.4%	1 Connecticut	\$6,544	1 Connecticut	13.80%	1 Connecticut	30.30%
2 Hawaii	8.9%	2 Massachusetts	9.5%	2 Massachusetts	\$6,085	2 Massachusetts	11.70%	2 Illinois	28.40%
3 Massachusetts	8.3%	3 Connecticut	9.5%	3 Hawaii	\$5,257	3 Hawaii	10.50%	3 Hawaii	24.80%
4 New Jersey	6.7%	4 New Jersey	7.0%	4 New Jersey	\$4,281	4 New Jersey	9.40%	4 Kentucky	20.50%
5 Mississippi	5.1%	5 Illinois	5.6%	5 New York	\$3,082	5 Illinois	9.20%	5 Massachusetts	19.90%
6 Illinois	4.7%	6 Delaware	5.5%	6 Illinois	\$2,919	6 New York	8.10%	6 New Jersey	19.10%
7 Kentucky	4.5%	7 Mississippi	5.2%	7 Washington	\$2,662	7 Washington	7.70%	7 Pennsylvania	17.90%
8 Washington	4.1%	8 New York	5.2%	8 Delaware	\$2,587	8 Kentucky	7.30%	8 Maryland	17.50%
9 New York	4.1%	9 Kentucky	5.1%	9 California	\$2,188	9 Maryland	7.00%	9 West Virginia	16.00%
10 Rhode Island	4.0%	10 Washington	5.0%	10 Rhode Island	\$2,188	10 Mississippi	6.90%	10 Utah	14.20%

<sup>1</sup> Moody's investors service, "Medians – State debt continues slow growth trend from April 24, 2018"

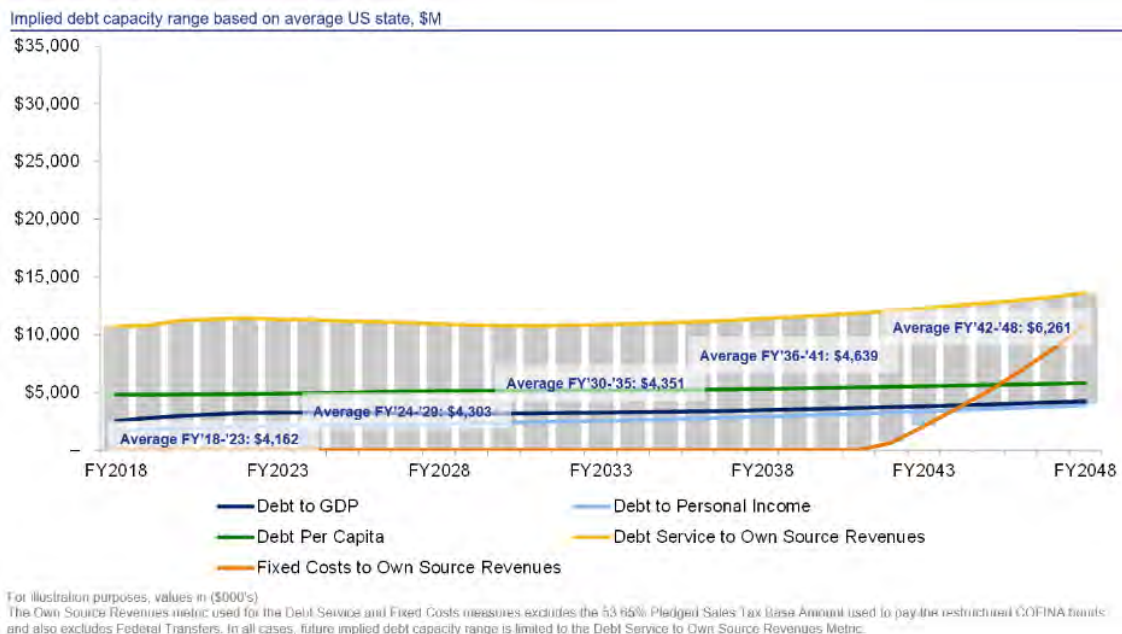
<sup>2</sup> Moody's investors service, "Medians – Adjusted net pension liabilities spike in advance of moderate declines from August 27, 2018"

"Fixed costs" are the FY2017 sum of each state's (1) net tax-supported debt service expense and their (2) actual budgetary contributions to pension expense and retiree health care ("OPEB"), as reported by Moody's

**Exhibit 25** uses the long-term 30-year macroeconomic forecast to determine a range of implied debt capacity based on the debt and fixed cost metrics of the *average* U.S. state. The debt capacity ranges shown are based off the following five methodologies: (i) debt to own-source revenues, (ii) debt per capita, (iii) debt to state personal income; (iv) debt to GDP and

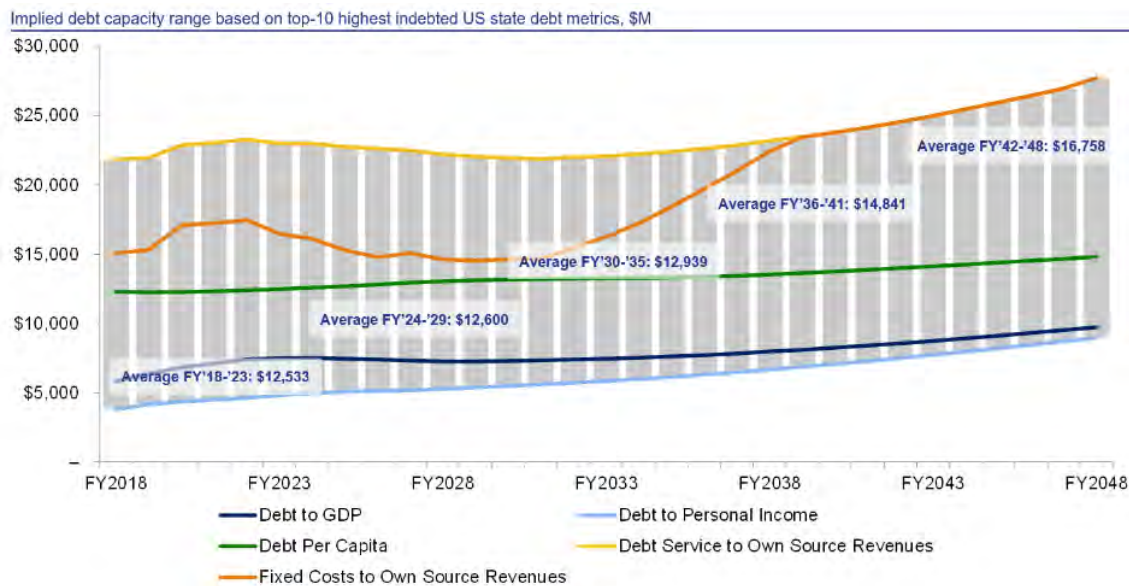
(v) fixed costs to own-source revenues. Implied debt capacity and expected growth in debt capacity must be sufficient to cover both restructured debt and debt service on any future new money capital borrowings Puerto Rico needs to maintain its public infrastructure. To the extent new and additional revenues are enacted in the future, including revenues designed to support future capital projects or generated by public-private partnership infrastructure investments, then those initiatives could generate additional debt capacity for Puerto Rico that is not reflected in the current New Fiscal Plan projections. The 5-year average capacity statistics represent the average par amount between the four methodologies of an implied 5% 30-year level debt service structure. Moody's defines "fixed costs" as the sum of a state's annual debt service and its annual budgetary pension and retiree health care (i.e. OPEB) expenditures. Given that Puerto Rico's public employee pension system is essentially zero percent funded—and that as a consequence the central Government must pay pension expenditures on a fully "pay go" basis from budgeted revenues each year—the fixed costs ratio helps capture that burden in comparison to the level of fixed costs as a percentage of Own-Source Revenues for U.S. States.

EXHIBIT 25: IMPLIED NET TAX-SUPPORTED DEBT CAPACITY RANGE BASED ON AVERAGE U.S. STATE (\$M)



**Exhibit 26** uses the long-term 30-year macroeconomic forecast to determine a range of implied debt capacity based on the debt metrics of the *10 highest indebted* U.S. states. The debt capacity ranges shown are based off the following four methodologies: (i) debt service to own source revenues, (ii) debt per capita, (iii) debt to state personal income, (iv) debt to GDP and (v) fixed costs to own-source revenues. Implied debt capacity and expected growth in debt capacity must be sufficient to cover both restructured debt and future debt issuance. The 5-year average capacity statistics represent the average par amount between the four methodologies of an implied 5.0% 30-year level debt service structure.

EXHIBIT 26: IMPLIED NET TAX-SUPPORTED DEBT CAPACITY RANGE BASED ON TOP-10  
HIGHEST INDEBTED U.S. STATE DEBT METRICS (\$M)



For illustration purposes, values in (\$000's)

The Own Source Revenues metric used for the Debt Service and Fixed Costs measures excludes the 53.85% Pledged Sales Tax Base Amount used to pay the restructured COFINA bonds, and also excludes Federal Transfers. In all cases, future implied debt capacity range is limited to the Debt Service to Own Source Revenues Metric.

The illustrative implied levels of the Government's restructured debt in the previous chart are calculated by applying the Net Tax Supported Debt ratios of the "top ten" U.S. states (in terms of debt load) to Puerto Rico's future projected GDP, population and Own-Source Revenues. Debt Service to Own Source Revenue and Fixed Costs to Own Source Revenues figures are derived assuming debt service of a long-term level debt service structure, with a 5% average coupon.

**Maximum annual debt service cap on restructured fixed payment debt.** The implied debt capacity and expected growth in debt capacity must be sufficient to cover both the payments due on the restructured debt and all payments due on future new money borrowings. Accordingly, the aggregate debt service due on all fixed payment debt issued in the restructuring of the Government's existing tax-supported debt should be capped at a maximum annual debt service ("MADs") level. The cap would be derived from the U.S. state rating metrics, and specifically from what Moody's calls the "Debt Service Ratio." The Debt Service Ratio is the ratio of total payments due in a year on all existing net tax-supported debt over that state government's own-source revenues (i.e., excluding federal transfer payments) in that year.

The Moody's report indicates that the average Debt Service Ratio for the all U.S. states is 4.5%. The Moody's report indicates that the average Debt Service Ratio for the top 10 most indebted states is 9.2%. To the extent either of these Debt Service Ratios is used to set a MADs cap on the restructured debt and the Primary Surplus is below the MADs level, then the debt service due on fixed payment debt would need to be set at the lower of the amount available for debt service or the MADs limit.

With respect to the Moody's Fixed Costs Ratio, the August 2018 Moody's report indicates that the average Fixed Costs Ratio for all U.S. States is 10.3%. The same report indicates that the average Fixed Costs Ratio for the 10 States with the highest Fixed Costs Ratios is 20.9%.

Any additional cash flow above the MADs cap applied to the restructured fixed payment debt that is generated over the long-term from successful implementation of the New Fiscal Plan could be dedicated to a combination of contingent “growth bond” payments to legacy bond creditors, debt service due on future new money borrowings needed to fund Puerto Rico’s infrastructure investments and additional “PayGo” capital investment to reduce the Government’s historically out-sized reliance on borrowing to fund its needs, among other purposes.

**Debt sustainability analysis.** Exhibit 27 below calculates implied debt capacity based on a range of interest rates and New Fiscal Plan risk factors under an assumed illustrative 30-year term and level debt service. The risk factor is calculated by reducing the amount of projected cash flow available per year for debt service by a certain percentage. For example, a 20% risk factor case would use only 80% of the projected cash flow available to pay debt service on fixed payment debt.

EXHIBIT 27: IMPLIED DEBT CAPACITY BASED ON RANGE OF INTEREST RATES AND RISK FACTORS (\$M)

Implied debt capacity based on range of interest rates and contingency, \$M					
Illustrative Cash Flow Available		Sensitivity Analysis: Implied Debt Capacity at 20% Risk			
		\$400	\$600	\$800	\$1,000
Sensitivity Analysis: Varying PV Rates	4.0%	\$5,533	\$8,300	\$11,067	\$13,834
	5.0%	4,919	7,379	9,838	12,298
	6.0%	4,405	6,607	8,809	11,012
Illustrative Cash Flow Available		Sensitivity Analysis: Implied Debt Capacity at 5% PV Rate			
		\$400	\$600	\$800	\$1,000
Sensitivity Analysis: Varying Risk	10.0%	\$5,534	\$8,301	\$11,068	\$13,835
	20.0%	4,919	7,379	9,838	12,298
	30.0%	4,304	6,456	8,609	10,761
*Values in \$millions					

**Restoration of cost effective market access.** Without delay, the Government must develop and adhere to structurally balanced budgets reflecting ongoing fiscal discipline, timely publication of audited financial statements and related disclosure information; it must restructure its current excessive debt load to a sustainable level. As Puerto Rico seeks to regain cost-effective capital markets access, rating analysts and investors will demand that the Commonwealth demonstrate improvement in all four core areas of creditworthiness identified by Moody’s: the economy, government finances, governance and “fixed cost” debt service and pension expenditures. Together, these and other measures outlined in the New Fiscal Plan can chart a path to restoring Puerto Rico’s market access.

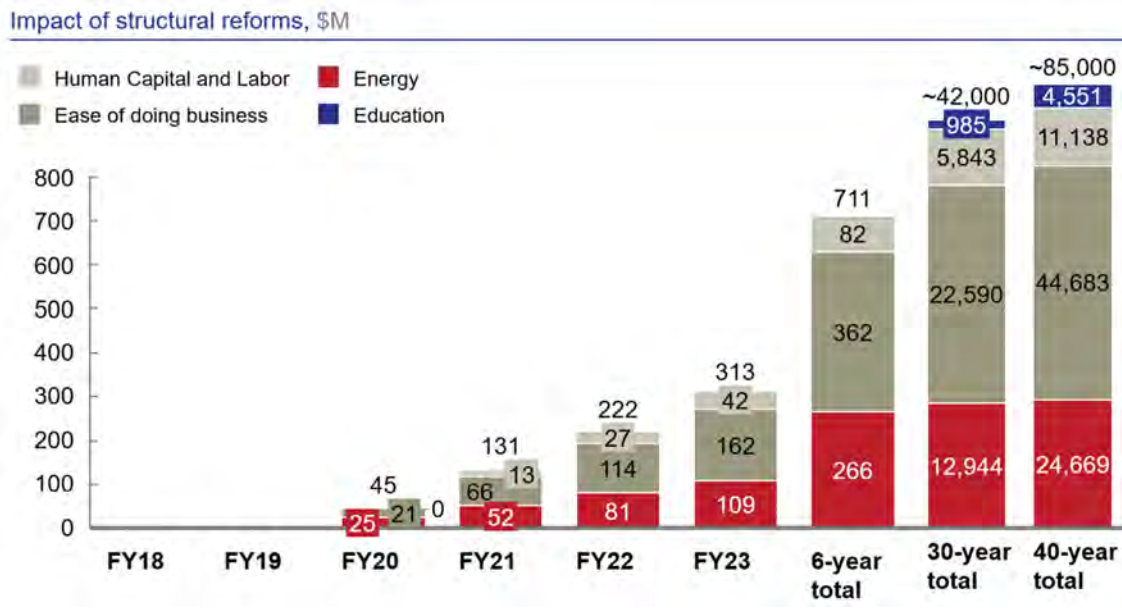
## PART III: Restoring growth to the Island

A sustainable fiscal and economic turnaround depends largely on comprehensive structural reforms to the economy of Puerto Rico. Only such reforms can drive growth in the economy, reversing the negative growth trend over the last ~10 years and enabling the Island to become a vibrant and productive economy going forward. To reverse the negative economic trends, the Government must pursue reforms in the following areas:

- **Human capital and welfare reforms** will improve workforce participation and the well-being and self-sufficiency of welfare recipients, resulting in a cumulative GNP impact of 0.15% by FY2021. The impact is enhanced in the long-term as K-12 education reforms begin adding an additional 0.01% GNP impact per year, resulting in an additional 0.26% by FY2058.
- **Ease of doing business reforms** will improve conditions for economic activity, job creation, and business vitality, resulting in a cumulative GNP impact of 0.50% by FY2022.
- **Power sector reforms** will improve availability and affordability of energy for families and businesses, resulting in 0.30% cumulative GNP impact by FY2021.
- **Infrastructure reform and capital investment** will improve the flow of goods, services, information, and people across the Island. It has not been scored to provide a specific GNP uptick, yet undoubtedly contributes a consequential uptick in the Island's long-term development.

**If implemented immediately, the structural reforms are projected to result in a sustained 0.95% annual increase to real GNP growth by FY2023.** As shown below (**Exhibit 28**), these reforms equal approximately \$40 billion in increased Commonwealth revenues over 30 years (and over \$80 billion over 40 years). In the long term, **education reforms are projected to add an additional cumulative 0.26% to GNP growth, making total impact 1.11% by FY2048 and 1.21% by FY2058.**

## EXHIBIT 28: IMPACT OF STRUCTURAL REFORMS OVER 40 YEARS



**Within this set of reforms, a core area is missing—the transformation of the labor market through the repeal of Law 80 and institution of at-will employment in Puerto Rico.** The high cost of hiring individuals on the Island—due to the lack of at-will employment as well as generous paid leave requirements—has served as a major barrier to job creation and growth and placed Puerto Rico at a direct disadvantage versus the mainland. Until the Puerto Rican Government institutes comprehensive labor reform, Puerto Rico will struggle to attract the level of new investment and job creation it needs to achieve required growth. As a result, while this section outlines a series of important reforms needed for growth, it should not be seen as a comprehensive overview of how to restore positive long-term growth and fiscal balance to the Island.

## Chapter 7. HUMAN CAPITAL & WELFARE REFORM

### 7.1 Current state of human capital and welfare laws

Puerto Rico faces immense challenges with formal labor force participation and preparedness. The Island's formal labor force participation rate is only ~40%, far from the U.S. mainland average (63%) and even the lowest-ranked U.S. state (West Virginia, 53%), and well below other Caribbean islands. In fact, according to World Bank data, Puerto Rico's formal labor force participation rate is currently 7<sup>th</sup> lowest in the world and has never ranked higher than the bottom 20.<sup>24</sup> Puerto Rico's youth unemployment rate is 22.9%, almost double the world average (13.4%) and more than double the U.S. average (9.2%).<sup>25</sup> Low labor force participation in Puerto Rico is a function of neither Hurricane Maria nor the economic downturn that began in 2006; rather, low rates of employment are a long-term structural problem that can be addressed only through significant changes to public policy.

<sup>24</sup> Puerto Rico ranking has never surpassed 215<sup>th</sup> out of the 232 countries, states, and territories tracked by The World Bank Group since The World Bank Group began collecting data in 1990

<sup>25</sup> The World Bank Group, 2017, via International Labour Organization, ILOSTAT database. Data retrieved in March 2017. <https://data.worldbank.org/indicator/SL.UEM.1524.ZS>

Unless Puerto Rico substantially increases its labor force participation and employment, incomes will always be far below those of residents in mainland states and outmigration will continue to draw Puerto Ricans away from the Island. Puerto Rico could improve labor market flexibility through repealing restrictive laws like Law 80 and creating labor conditions more similar to those on the mainland, which would lead to increased labor force participation rates. If Puerto Rico's labor force participation rate were to grow to match even to that of the lowest U.S. state, incomes would rise, poverty would decline, and the budgetary deficit would improve. Increasing labor force participation and job creation may be the single most important reform for long-term economic well-being in Puerto Rico.

While the political will to drive labor market reform does not exist, the Government has prioritized welfare reform in the form of instituting an Earned Income Tax Credit (EITC) and NAP work requirement, both of which will provide incentives for Puerto Ricans to seek jobs in the formal economy. To successfully institute these new reforms, the Government will need to design these programs so that they drive the intended result rather than just adding to the funding burden of the Government.

### *7.1.1 Labor laws*

Puerto Rico's historically low levels of formal labor force participation cannot be attributed to any single factor, but a range of public policies have served to reduce employment on the Island.

Perhaps the biggest barrier to hiring in Puerto Rico is its lack of "at-will employment," which would make it easier for employers to dismiss unsatisfactory employees. While there are variations in labor laws among the 50 mainland states, 49 of them have adopted some form of at-will employment. In Puerto Rico, Law 80 was passed in 1976 requiring employers to first prove "just cause" before dismissing employees. Law 80's "just cause" requirement applies to any employees hired for an indeterminate period of time, as well as any employee with a tenure longer than twelve months. In addition, Law 80 mandates significant severance pay: 3 months' base wages, plus two weeks' additional wages for every year of the outgoing employee's tenure. The need to establish just cause can be costly for employers because it typically leads to litigation, and many employers simply pay severance to an unsatisfactory employee to avoid a court dispute. Labor flexibility legislation that reduces like Law 80 can also have the additional effect of skewing investment to capital rather than labor, reducing the positive impact of any surplus on the labor market.

While some employees benefit from Puerto Rico's lack of at-will employment, this policy makes it more costly and risky not only to dismiss, but also to hire, an employee. There is evidence that such job protections lower employment opportunities. For example, studies have found that laws preventing unfair dismissal caused reductions in employment, particularly in labor-intensive industries;<sup>26</sup> and in U.S. states, a recent study found that expanding unfair dismissal protections caused employers to shift away from using less skilled workers and toward greater use of capital investments and more skilled labor. When Colombia reduced the cost of dismissing workers, unemployment fell and the size of the informal labor force declined.<sup>27</sup> In a 2003 book on labor laws in Latin America and the Caribbean, Nobel Prize-winning economist James Heckman concluded that:

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<sup>26</sup> RAND Corporation, 1992

<sup>27</sup> Kugler (2004). See Dertouzos, James N., and Lynn A. Karoly. "Labor market responses to employer liability." Rand Corporation, 1992; Autor, David H., William R. Kerr, and Adriana D. Kugler. "Does Employment Protection Reduce Productivity? Evidence from U.S. States." *The Economic Journal* (2007): F189-F217; Heckman, James. *Law and employment: Lessons from Latin America and the Caribbean*. No. w10129. National Bureau of Economic Research, 2003; Kugler, Adriana D. "The effect of job security regulations on labor market flexibility. Evidence from the Colombian Labor

*"Mandated benefits reduce employment and... job security regulations have a substantial impact on the distribution of employment and on turnover rates. The most adverse impact of regulation is on youth, marginal workers, and unskilled workers. Insiders and entrenched workers gain from regulation but outsiders suffer. As a consequence, job security regulations promote inequality among demographic groups."*

The Government recently made strides to improve labor market conditions with the Labor and Flexibility Act (Act 4-2017) in January 2017, which added flexibility to overtime regulations and increased work requirements to become eligible for Christmas Bonus and severance pay, among other reforms. However, there is more work to be done.

### *7.1.2 Welfare policies*

In addition to the Island's labor laws, Puerto Rico residents may also face disincentives to participate in the formal labor market due to rules attached to various welfare benefits, including the Nutritional Assistance Program (NAP), Mi Salud (Medicaid), Section 8 public housing, TANF, WIC, and other programs.

These benefits are sometimes stereotyped with a claim that "welfare pays more than work." While this may be true in isolated cases, the broader problem occurs when welfare beneficiaries work in the formal sector and receive earnings that trigger a reduction in their benefits. The phase-out of government transfer benefits as earned income increases acts as a tax to disincentivize formal employment, as effective hourly wage (income received by working minus the loss of benefits) can be substantially lower than the formal hourly wages received. For many citizens, working in the informal sector and collecting transfer benefits can often result in higher effective income than working in the formal sector.

While transfer benefits in Puerto Rico are not more generous than on the mainland in dollar terms, they *are* more generous relative to generally lower earnings on the Island. When benefits are phased out as a beneficiary works, loss of benefits may be larger relative to earnings than for a mainland worker. This can serve as a greater disincentive to work than on the mainland.

It is difficult to quantify how large such disincentive effects may be due to limitations on the data available. Different individuals entitled to different sets of benefits are thus faced with various incentives that inform the ways they engage with the labor market. For a full-time minimum wage worker who receives significant assistance (e.g., TANF, Medicaid), the loss of benefits will offset most or all income received from work, leaving the household no better off.<sup>28</sup> It is reasonable to conclude that for many welfare beneficiaries, formal sector work may sometimes do little to increase household incomes.

Though few Puerto Rico residents receive all these benefits,<sup>29</sup> even receipt of a single type of benefits can alter incentives to engage in the formal workforce. For instance, a single mother with two children and annual income below \$4,900 is eligible to receive approximately \$4,229 in annual NAP ("food stamp") benefits. But should that individual work 35 hours per week at

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Market Reform." In *Law and Employment: Lessons from Latin America and the Caribbean*, pp. 183-228. University of Chicago Press, 2004

<sup>29</sup> See Héctor R. Cordero-Guzmán, "The production and reproduction of poverty in Puerto Rico," in Nazario, Carmen R., ed. *Poverty in Puerto Rico: A Socioeconomic and Demographic Analysis with Data from the Puerto Rico Community Survey (2014)*. Inter American University of Puerto Rico, Metro Campus, 2016. Cordero. Notes that the number of TANF beneficiaries in Puerto Rico is relatively modest and many, due to age or disability, are unlikely to work under any conditions

the minimum wage, her annual earnings of \$12,180 would cause her to lose eligibility for food stamps. Net of taxes on her earnings, working full-time would increase her household's annual income by only \$7,002, equivalent to an hourly wage of only \$3.86. Under those conditions, some individuals may choose not to work in the formal labor market.

Mainland states face many of these same incentive issues, which they address in two ways. First, residents of mainland states are eligible for the federal Earned Income Tax Credit (EITC), which provides a partial refund against federal income taxes for eligible low-income workers. Many states supplement the federal EITC to increase benefits to recipients. By increasing the reward to work, the EITC has been shown to increase labor force participation.<sup>30</sup> However, because Puerto Rico residents do not pay federal income taxes they are not currently eligible for the federal EITC.

Likewise, the Federal Government requires that food stamp programs on the mainland (Supplemental Nutrition Assistance Program, "SNAP") contain a work requirement. In general, working-age SNAP beneficiaries on the mainland must register for work, cannot turn down a job if offered, and may be required by the state to attend education or work training classes. In addition, federal law requires that non-disabled adults without dependents must work, attend education, or volunteer at least 20 hours per week to maintain eligibility for benefits.

Puerto Rico's labor and welfare laws may help explain why, despite the Island's natural beauty, attractions and ease of access from the U.S. market, employment in tourism-related industries is low. According to the Federal Bureau of Labor Statistics (BLS), Puerto Rico employs only 80,000 individuals in the leisure and hospitality industries—10,000 fewer tourism-related jobs than the state of Nebraska, which both lacks Puerto Rico's natural assets and has an overall population over one-third smaller than that of Puerto Rico.

### *7.1.3 Workforce preparedness*

Finally, Puerto Rico's potential workforce is also not well prepared to fill jobs currently needed by the economy. Poor skill development is largely driven by low educational quality and attainment. Around 20% of Puerto Rico's working age population has less than a high school diploma (compared to U.S. average of under 12%), and about 30% of that same population has a college degree, which is about 3 percentage points below the mainland average.<sup>31</sup> Meanwhile, Puerto Rico's public schools are underperforming. PRDE K-12 schools have shown declining performance over the past two decades. Today a quarter of students do not graduate high school at all,<sup>32</sup> while the remainder graduate below basic proficiency levels: in standardized tests, only about half perform at a basic level in Spanish,<sup>33</sup> 35% perform at a basic level in Mathematics, 35% perform at a basic level in English and 43% at a basic level in Science.<sup>34</sup> Of the 71 countries measured through OECD PISA scores, Puerto Rico scored 57th in reading

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<sup>30</sup> See Eissa, Nada, and Jeffrey B. Liebman. "Labor supply response to the earned income tax credit." *The Quarterly Journal of Economics* 111, no. 2 (1996): 605-637

<sup>31</sup> Federal Reserve Bank of New York, "An Update on the Competitiveness of Puerto Rico's Economy." July 31, 2014. <https://www.newyorkfed.org/medialibrary/media/outreach-and-education/puerto-rico/2014/Puerto-Rico-Report-2014.pdf>

<sup>32</sup> Puerto Rico Department of Education Consolidated State Plan (ESSA), 2017; <https://www2.ed.gov/admins/lead/account/stateplan17/prconsolidatedstateplanfinal.pdf>

<sup>33</sup> As of ESSA Consolidated State Plan 2017

<sup>34</sup> "Basic level" is defined by National Assessment of Education Progress test administrator as "partial mastery of prerequisite knowledge and skills that are fundamental for proficient work at each grade" and is the bottom of three levels of achievement with the other levels being "proficient" and "advanced." Source: "Medición y Evaluación para la Transformación Académica de Puerto Rico (META-PR) 2015-2016 School Year," PRDE (2016)

(U.S. 24th), 63rd in science (U.S. 25th), and 65th in math (U.S. 40th).<sup>35</sup> These challenges contribute to Puerto Rico's rate of youth unemployment, which is more than double the rate in the U.S. mainland.<sup>36</sup>

Puerto Rico has therefore not solved the supply or demand side issues with its labor market—creating huge barriers to economic growth and sustainability for the Island.

## **7.2 Future vision for the Puerto Rican human capital and welfare reform**

Changes to labor and welfare laws are controversial. It is difficult to ask Puerto Rican residents to give up benefits and job protections when, through the economic downturn and then Hurricane Maria, they already have lost so much. Nevertheless, dramatic changes to Puerto Rico's labor market policies are necessary to provide Puerto Ricans the opportunity for a greater standard of living at home, reversing the Island's history of high poverty, constrained budgets, and pressure for young Puerto Ricans to leave their home for the mainland. To ensure Puerto Rico can provide opportunities for its people for years to come, structural reforms must make it easier to hire, encourage workforce participation, and enhance student outcomes and workforce development opportunities to ensure a pipeline of prepared and appropriately-skilled individuals.

**Unfortunately, there was no political will to enact the labor reform proposal outlined in the April 19, 2018 version of the New Fiscal Plan, or to repeal Law 80 as was required by the May 30, 2018 version of the New Fiscal Plan.** Additionally, the Government recently announced several new pieces of legislation and executive orders that will contribute to the restrictive business and costly hiring environment on the Island. One such executive order mandates an increase the minimum wage for construction workers in the public sector, which will directly affect recovery projects driven by disaster funding. Accordingly, while robust labor reform would have been projected to generate approximately \$42 billion in additional revenues by FY2048 and over ~\$400 million from FY2018-FY2023, the New Fiscal Plan projects that the human capital and welfare reforms to which the Government has committed will only generate 0.15% growth for the Island by FY2023, rather than 1% growth.

## **7.3 Structural reform initiatives for human capital and welfare reform**

Structural reforms should increase incentives and preparedness to work. While full-fledged labor reform has not been implemented, the Government must enact welfare reform measures to encourage formal labor force participation. These reforms should include an Earned Income Tax Credit (EITC) for low-income workers, a work requirement for able-bodied NAP beneficiaries, and programs to develop critical skills in the workforce and improve employment readiness for jobseekers and students.

### ***7.3.1 Welfare structure reforms***

To implement the human capital and welfare reform package, address labor market challenges and encourage residents to participate in the formal labor market, the Government must

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<sup>35</sup> Programme for International Student Assessment (PISA) 2015 Assessment and Analytical Framework, The Organization for Economic Co-operation and Development, August 31, 2017

<sup>36</sup> The World Bank Group, via International Labour Organization, ILOSTAT database. Data retrieved in March 2017. <https://data.worldbank.org/indicator/SL.UEM.1524.ZS>. <https://data.worldbank.org/indicator/SL.UEM.1524.ZS>

launch an Earned Income Tax Credit (EITC) program by January 2019, raising pay for formal laborers. The Government also must institute a work requirement for the Nutrition Assistance Program (NAP) by July 1, 2019, with no transition period (e.g., full requirements regarding work will begin in July).

### **Earned Income Tax Credit (EITC)**

The EITC is a benefit for working people with low to moderate income. To qualify, people must meet certain requirements and file a tax return, even if they do not owe any tax. The EITC reduces the amount of taxes owed and may result in a cash refund if the benefit is higher than owed taxes.

Since welfare reform in 1996, the EITC has become the cornerstone of anti-poverty policy in the United States. It has refocused the U.S. safety net on working families, dramatically increasing employment among single women with children and removing more children from poverty than any other program. Over the years, the mainland EITC program has translated to approximately 6.5 million people (half of whom are children) lifted out of poverty, improved employment rates (a \$1,000 increase in EITC benefit has been tied to a 7.3 percent increase in employment),<sup>37</sup> and provided increased opportunities for individuals to invest in their own futures with education, training, childcare, or other costs that improve longer-term outlook.

From 2006 to 2014, Puerto Rico had a Worker's Tax Credit, which was later discontinued due to its ineffective application. This prior Work Credit applied to 45% of all tax filers at a cost of \$152 million in its last year of implementation. It was smaller than federal EITC programs (\$150-450 versus ~\$2,000 average credit), and did not eliminate high implicit tax rates on low-income employees or do enough to incentivize formal employment.<sup>38</sup>

In Puerto Rico, implementation of the new EITC should be similar to the federal EITC but adjusted to the relative wages of the Island. Eligible recipients should receive credits according to their marital, family, and earned income.<sup>39</sup> As earnings increase, the benefit should increase up to a specified cap; at the cap, it would plateau and eventually decrease at the phase-out income level until it reaches \$0 (**Exhibit 29**), resulting in an average benefit of \$525.30 per individual per year. This structure diminishes the "benefits cliff" many face as their earned income increases, rewarding citizens who participate in the formal economy.

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<sup>37</sup> Hoynes and Patel 2015, <http://www.taxpolicycenter.org/briefing-book/how-does-eitc-affect-poor-families>

<sup>38</sup> New York Federal Reserve Bank, 2014

<sup>39</sup> Eligible participants in an Earned Income Tax Credit program must meet several criteria specified by the IRS: namely, they must earn income through either employment or self-employment (i.e. owning or running a business or farm), they must earn income within the specified limits, and they must either file for a qualified child, or qualify without a qualifying child.

EXHIBIT 29: EITC BENEFIT FORMULA

EITC Benefit Formula, \$						
<ul style="list-style-type: none"> <li>Benefits begin with the first dollar of reported income. As income increases, <b>benefits also increase at the phase-in rate</b> (different depending on household size), <b>up to the maximum credit</b></li> <li>When income <b>reaches the phase-in cap, the benefit increase ceases</b>. Benefits remain constant at income levels that fall between the phase-in cap and phase-out start</li> <li>When income <b>reaches the phase-out start, benefits begin decreasing at the phase-in rate</b> for each additional dollar earned, <b>until income reaches the income cap</b> (at which point benefits are \$0)</li> </ul>						
Number of Children	Phase-in rate, %	Phase-in cap, \$	Phase-out start, \$	Individual/ Single income cap, \$	Married income cap, \$	Maximum Credit, \$
0	5.00%	6,000	18,000	20,500	21,750	300
1	7.50%	12,000	13,000	20,500	24,250	900
2	10.00%	15,000	16,000	28,500	34,750	1,500
3 or more	12.50%	16,000	17,000	33,500	42,000	2,000

For example, a single mother with two children working at minimum wage for 35 hours per week earns approximately \$12,180 annually. With EITC, she can qualify for up to \$1,500 in additional take-home pay per year, effectively raising the minimum wage by more than 12%.

The EITC program would cost approximately \$200 million per year, but the program will raise formal labor force participation significantly, providing a positive return on the investment. The EITC must be instituted and in effect no later than January 2019.

### NAP Work requirement

While NAP (also known by the Spanish acronym, PAN), Puerto Rico's largest welfare program, is similar to the mainland SNAP, it is funded and administered separately and does not include a work requirement. As part of the human capital and welfare reform package that the Oversight Board projects will create substantial growth over the next 40 years, the New Fiscal Plan requires that the Government institute work requirements to qualify for NAP benefits.

Starting in July 2019, able-bodied participants aged 18-59 will be subject to a work requirement; Puerto Rico must complete its application for the program by July 2018. Like mainland SNAP, this work requirement must become effective after the individual has collected NAP benefits for three months. The work requirement may be satisfied with 80 hours per month of paid work, volunteer work, and/or qualified training and education. General exceptions would include those under age 18 or over age 60, parents with dependents under age 18, as well as those who are medically certified as physically or mentally unfit for employment. Children, even if their parents do not work, will continue to receive the benefit.

Any program savings derived from the NAP work requirement must be redistributed to working beneficiaries, effectively increasing take-home pay for workers. The increased worker benefit shall take place through an expansion of the Earned Income Disregard, which will increase the amount of earned income eligible recipients can exclude in calculating the amount of benefits they can claim. For example, a family of four currently receiving NAP will lose the benefit after exceeding a maximum annual income of \$5,904. By creating a sliding scale after this amount, or allowing families to exclude a certain amount of earned income from this

calculation, Puerto Rico can ensure no one is disadvantaged by seeking work in the formal economy and that no families lose benefits prematurely.

The increase in NAP benefits for workers combined with the EITC would improve conditions for low-income workers in the formal economy and reduce poverty.

### *7.3.2 Workforce development programs*

Human capital and welfare reforms should increase supply and demand for jobs; to fully close the gap and implement the human capital and welfare reform package, however, the Government must launch specific efforts to ensure that its future workforce is prepared with critical skills.

#### **Workforce Innovation and Opportunity Act (WIOA)**

First, the Government must update the WIOA State Plan to focus its programs and incentives on high-priority sectors and capabilities (e.g., aerospace, software development, and creative services). WIOA is the primary way in which the Federal Government invests in adult education and workforce development, and it is designed to help jobseekers access employment, education, and support services to succeed in the labor market, and to match employers with the skilled workers they need. The Government must broaden the list of core industries that qualify under WIOA, and focus on high impact economic sectors to provide a skilled workforce that meets the needs of employers in each specific region. It should integrate this WIOA program with the broader promotional efforts of the Department of Economic Development and Commerce (DDEC). For example, an MOE Agreement with the Puerto Rico Department of Labor and Human Resources should establish an apprenticeship program aiming to impact innovative industries and post-Maria labor market needs.

#### **Youth development initiatives**

In addition to WIOA, the Government should help develop critical skills in the workforce through multiple proposed initiatives, including:

- **Youth development:** Investment in STEM through targeted teacher professional development and related programs; apprenticeship programs through partnership with universities and local businesses; opportunities for work-based learning and business programs; occupational opportunities and certification programs
- **Higher education:** Curriculum development grants and scholarships for UPR students focused on high-impact sectors, e.g., the IT industry and Computer Science.
- **Current labor market:** Apprenticeship Programs through collaboration with the private sector; training & certification programs focused on the areas of reconstruction efforts; creation of a job council to coordinate development and employment opportunities for youth and the unemployed

By pursuing aggressive reforms to incentivize job creation and formal labor market participation, and to improve the overall quality of human capital in Puerto Rico, the Government will fundamentally transform the Island's labor market for the better.

## **7.4 Implementation and enforcement of human capital and welfare reform**

The New Fiscal Plan requires that EITC must be in effect by January 2019 and that the proposed NAP work requirements be included in the new NAP annual plan submitted July 1, 2018 to Food and Nutritional Services, and by July 1, 2019, that full requirements will take

effect, subjecting beneficiaries to the work requirement after 3 months of benefit collection. A qualified third-party analytical firm retained by the Government and acceptable to the FOMB must validate that these work requirements are being fully implemented. This third party will share equal information about its work with both the Government and FOMB.

A full set of expected milestones are below (**Exhibit 30**). The Government must fulfill these milestones in order to be compliant with the New Fiscal Plan and to give the Oversight Board confidence that they are able to hit relevant savings and growth targets. Without such reforms, the revenue that would be lost over the time of New Fiscal Plan would need to be found elsewhere in the budget.

**EXHIBIT 30: HUMAN CAPITAL AND WELFARE REFORM KEY IMPLEMENTATION MILESTONES**

Areas of focus	Action item	Deadline
Earned Income Tax Credit	▪ Enact EITC legislation	November 30, 2018
	▪ Publish timeline for regulatory guidance for practitioners and taxpayers	December 31, 2018
	▪ Develop and initiate outreach and education plan to maximize participation among eligible taxpayers	January 15, 2019
	▪ Complete comprehensive fraud mitigation plan	March 31, 2019
	▪ Release draft forms including what documentation is required to claim credit	June 30, 2019
	▪ Complete systems changes needed to process EITC returns	September 30, 2019
	▪ Open tax filing season and begin paying EITC claims	January 1, 2020
	▪ Monitor and publish take-up of EITC	Ongoing
PAN Work Requirement	▪ Submit PAN work requirement proposal to FNS	July 1, 2018
	▪ Receive approval from FNS for new program	October 1, 2018
	▪ Publish FNS-approved state plan, which details PAN work requirement and confirms alignment with Fiscal Plan requirements	October 31, 2018
	▪ Hire a qualified third-party analytical firm (acceptable to the FOMB) to oversee implementation of work requirement	December 31, 2018
	▪ Launch eligibility review for PAN recipients	April 1, 2019
	▪ Full PAN work requirement takes effect, thereby subjecting beneficiaries to the work requirement after three months of benefit collection	July 1, 2019
	▪ Receive review from qualified third-party analytical firm that PAN work requirement is being fully implemented	September 30, 2019
	▪ Publish annual report on PAN impact	December 31, 2020
Workforce development	▪ Monitor and publish key metrics of PAN	Ongoing
	▪ Identify high-priority sectors and capabilities	June 30, 2018
	▪ Update the WIOA State Plan to focus on high-priority areas and integrate WIOA program with broader DDEC initiatives	September 30, 2018
	▪ Publicly announce partner organizations (public and private) for apprenticeship, training, and certification programs	December 31, 2018
	▪ Establish job council to coordinate development and employment opportunities for youth and the unemployed	March 31, 2019
	▪ Publicly announce details of apprenticeship, training, and certification programs	April 30, 2019
	▪ Launch apprenticeship, training, and certification programs	July 1, 2019
	▪ Publish key metrics related to impact	Ongoing

## Chapter 8. EASE OF DOING BUSINESS REFORM

### 8.1 Current state of business regulation and investment attraction

One of the best ways to increase economic growth is by reducing a variety of inefficiencies related to building, expanding and attracting businesses. Easier-to-navigate regulations, less complex and faster permitting processes, and other legal and regulatory changes can encourage new businesses to hire employees and invest in growth. To quantify a jurisdiction's overall effectiveness in this regard, the World Bank created the Doing Business Index, which ranks 190 countries and entities worldwide on several core indicators. Countries and territories that have been able to meaningfully improve their ranking have shown real growth. For example, when the Republic of Georgia improved its ranking from #98 in 2006 to #8 by 2014, output per capita increased by 66% and business density tripled. Meanwhile, ease of doing business remains an area in which Puerto Rico has much room for improvement.

In the 2018 Ease of Doing Business Report, Puerto Rico was ranked 64<sup>th</sup>. This represents a 9-point decline from 2017 and is 58 spots lower than the U.S., which ranks 6<sup>th</sup> overall. There are some areas of strength: Puerto Rico placed 6<sup>th</sup> for Getting Credit and 9<sup>th</sup> for Resolving Insolvencies.<sup>40</sup> It has also made recent efforts to digitize government services to improve speed and accessibility, having launched the Single Business Portal (SBP) in July 2018, which currently includes online filing system for defined Acts (Acts 14, 20 and 22) but will ultimately consolidate permit requests, filing for incentives and annual reporting on these Acts. However, when compared to the mainland, Puerto Rico has several areas for improvement, in particular:

**Getting Electricity (rank 69, U.S. 49):** Energy costs remain a major inhibitor to operating large-scale business efficiently on the Island. Electric bills for similar amounts of electricity can cost twice as much in Puerto Rico as it would in the U.S. mainland.<sup>41</sup> Puerto Rico's low ranking is also driven largely by low reliability of supply and transparency of tariff index rated a 4 (on a 0 to 8 scale) by the World Bank, compared to 8 on the U.S. mainland.<sup>42</sup>

**Dealing with Construction Permits (rank 138, U.S. 36):** It takes 22 procedures and 165 days to get a construction permit in Puerto Rico, compared to 5 procedures and 89 days in the mainland United States. Obtaining a permit in Puerto Rico costs 6.2% of total future value of the permit (vs. 0.3% in the mainland United States). Despite these challenges, Puerto Rico is already strong in its building quality control index (12 on a 0-15 scale, compared to 8 for the mainland United States).

**Registering Property (rank 153, U.S. 37):** It takes 191 days to register property in Puerto Rico, compared to 12 days in the mainland United States.

**Paying Taxes (rank 161, U.S. 36):** Puerto Rico requires 16 payments per year (11 in U.S.), and it takes 218 hours per year to prepare, file, and pay the corporate income tax (175 in U.S.). Puerto Rico also has a comparatively high total tax and contribution rate at 63.4%,<sup>43</sup> compared to 45.8% in the mainland United States.

In addition to needing to improve its overall business regulatory climate, Puerto Rico is lagging in its ability to attract investment and tourism. For example, in 2015-2016 Puerto Rico saw its number of jobs and establishments declining (before the effects of Maria),<sup>44</sup> and it ranks 55<sup>th</sup> overall in the World Economic Forum's worldwide Travel & Tourism Competitiveness Index (while the U.S. rank is 6).<sup>45</sup> Countries that have focused on improving investment and tourism have seen great success. When Ireland created its Industrial Development Authority (IDA), it transformed Ireland into a popular location for new investments.<sup>46</sup> Ireland is now home to 9/10 of the world's top pharmaceutical and software companies. Meanwhile, when Barbados created its Tourism Product Authority in 2014, it began generating returns as soon as 1-2 years later: travel and tourism direct contribution to GDP increased by 5.4% in 2015 and 10.3% in

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<sup>40</sup> All economic rankings are benchmarked to June 2017. Rankings can be found in the World Bank's Doing Business reports: <http://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2018-Full-Report.pdf>

<sup>41</sup> The Guardian, "Puerto Rico's Soaring Cost of Living," 2015. <https://www.theguardian.com/world/2015/jul/12/puerto-rico-cost-of-living>

<sup>42</sup> All specific U.S. comparison based on New York City, as averages vary across the country

<sup>43</sup> The total tax rate measures the amount of taxes and mandatory contributions payable by the business in the second year of operation, expressed as a share of commercial profits

<sup>44</sup> Puerto Rico Department of Labor and Human Resources, Bureau of Labor Statistics. "Puerto Rico Economic Analysis Report 2015-2016." [https://www.doleta.gov/performance/results/AnnualReports/docs/2017\\_State\\_Plans/Economic\\_Reports/Puerto%20Rico/PR%20Economic%20Analysis.pdf](https://www.doleta.gov/performance/results/AnnualReports/docs/2017_State_Plans/Economic_Reports/Puerto%20Rico/PR%20Economic%20Analysis.pdf)

<sup>45</sup> As of 2015, latest available information for Puerto Rico. Puerto Rico was not included in World Economic Forum's 2017 report due to insufficient data

<sup>46</sup> In 2016, the IDA supported 60,000 jobs in 2016 at a cost of ~€9,000 per job sustained, and U.S. companies had invested ~€240 billion in FDI in the country

2016; and direct contribution of tourism to employment increased by 4.3% in 2015 and 9.8% in 2016.

The Government has made important efforts recently to generate investment in the Island by creating Discover Puerto Rico (DPR) and Invest Puerto Rico (iPR), with the goal of incentivizing foreign direct investment (FDI), private sector investment and tourism. However, while there are plans to operationalize both by the beginning of FY2019, these entities will need clear goals and metrics to be most effective.

## 8.2 Future vision for Ease of Doing Business reform

**Puerto Rico should achieve a best-in-class business environment by taking targeted steps to improve rankings in key identified Doing Business Index indicators by FY2023, with the goal of closing the gap with the mainland U.S. by at least 50% from its 2018 rankings:**

- Overall: Move from 64 to at least 57<sup>47</sup>
- Getting Electricity: Move from 69 to at least 59
- Construction Permits: Move from 138 to at least 87
- Registering Property: Move from 153 to at least 95
- Paying Taxes: Move from 161 to at least 99

In addition, in line with best-in-class investment offices,<sup>48</sup> by FY2023 **iPR should:**

- Create 54,000 new jobs (or average 9,000 new jobs per year)<sup>49</sup>
- Lead 750 new capital investments (or average 150 per year)<sup>50</sup>
- Achieve a \$20 return in 10 years per dollar invested<sup>51</sup>

In line with best-in-class Caribbean tourism offices,<sup>52</sup> by FY2023 **DPR should close Puerto Rico's distance with the highest ranked Latin American country and therefore:**

- Improve World Bank Travel & Tourism Competitiveness Index ranking to at least 43, closing the distance to the highest ranked Latin American country in 2018
- Drive 5% annual growth in direct contribution of tourism to GDP and 5% annual growth in direct contribution to employment<sup>53</sup>
- Improve tourist service infrastructure score Of 5.4 (2015) by 10% by improving number and quality of lodging services<sup>54</sup>

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<sup>47</sup> In line with the top ranked Latin American country in 2018

<sup>48</sup> Offices reviewed include: Ireland's Investment Development Agency (IDA), Enterprise Florida, JobsOhio, and Virginia's Economic Development Partnership (VEDP)

<sup>49</sup> Average of number of jobs created by IDA annually from 2005-2009 equaled 9,700/year. In five years, the U.S. was able to recreate all the jobs lost in the Great Recession, but this was in an environment of economic recovery and population growth. 15% is a more reasonable target for Puerto Rico

<sup>50</sup> Best practice examples: VEDP had 375 new investments in 2015; IDA had 244 total approved investments in 2016; VEDP tracked 320 companies counseled or participating in trade events

<sup>51</sup> VEDP estimates \$23 return on each dollar invested in 10 years (\$48 in 20 years). VEDP benchmark adjusted for PPP

<sup>52</sup> Such as the Barbados Tourism Product Authority and the Bahamas Ministry of Tourism

<sup>53</sup> Current state: 2.7% direct contribution to GDP and 2.1% of total employment as of 2016. Puerto Rico has historically seen an annual 4% growth rate in travel & tourism's direct contribution to GDP and 4.6% growth rate in travel & tourism's direct contribution to employment (2017). World Travel & Tourism Council, "Travel & Tourism Economic Impact 2017 – Puerto Rico." Barbados set up its Tourism Product Authority in 2014; in 2015, the country saw a 5.4% increase in travel & tourism direct contribution to GDP and 4.3% increase in direct contribution to employment; in 2016, 10.3% increase in tourism GDP and 9.8% increase in tourism employment

<sup>54</sup> 10% improvement bring tourist service infrastructure in line with Barbados at 5.9 quality score, top ranked Caribbean nation

- Establish exit surveys to measure visitor satisfaction, length of stay and spend for tourists to highlight key areas of improvement and focus for DMO<sup>55</sup>

### 8.3 Core initiatives to improve the Ease of Doing Business

To improve its Ease of Doing Business Rankings and overall tourism and investment outcomes, the Government should 1) pursue core initiatives such as digitizing government services, reducing border handling times, and driving deregulation and 2) establish clear metrics and regular tracking / reporting for iPR and DMO.

#### *8.3.1 Initiatives to improve ease of doing business rankings (e.g., digitize government services, drive de-regulation)*

While the Government has made major strides on digitization to date with the creation of the SUI, it must do more work to catch up to the mainland on key metrics that measure the time and energy expended to register, run, or expand a business.

**Digitize Unified Information System (SUI).** In addition to migrating government processes toward a streamlined and/or “one-stop shop” processes on SUI, the Government should move forms online to whatever extent is possible. This involves decoupling all non-related procedures from permitting, centralizing and digitizing permits. The Government should target 100% integration into SUI by end of 2018 for the following metrics: Licenses integrated into SUI; cases filed in SUI; cases issued in SUI; concerned entities integrated into SUI; and autonomous municipalities integrated into SUI.

**Reduce occupational licensing.** Reducing occupational licensing requirements can encourage activity in the formal labor market. Therefore, the Government should take inventory of all occupational licensing requirements and undertake reforms to reduce unnecessary regulations, creating a more open labor market. It will also consider joining U.S. mainland agreements to recognize licenses obtained in other states, such as the Compact for the Temporary Licensure of Professionals. Such an agreement enables professionals with licenses from other states to enter the Puerto Rican labor market without undue barriers.

**Deregulate on-Island freights.** Reducing the cost of transporting consumer goods and holding inventory will improve the service of carriers and shippers (thereby enhancing competition) and lower the overall cost of doing business on the Island.

**Deregulate condominium law.** Currently, condominium laws discourage investment in real property by requiring unanimous approval by all title owners in the condominium to execute a project. Deregulation can promote the development of investments by rental residents, increase population density and accelerate decision-making.

**Improve construction permitting.** Streamline the process for business permitting and registrations by creating a streamlined, digitized one-stop-shop system for business processes, expanding on work initiated under Act 19. Construction permits specifically required a drastic reduction in the time required (particularly the 120 days, or 73% of total time, due to municipal evaluation), and processes/procedures (reducing 22 procedures to at most 10). Finally, to reduce cost of receiving a construction permit, the Government should evaluate its municipal construction tax (80% of total cost).

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<sup>55</sup> For example, The Bahamas Ministry of Tourism uses high quality exit surveys to track and respond to visitor satisfaction and tourist habits

**Improve ease of registering property.** Streamline and digitize the property registry system to reduce delays from the Property Registry Agency. Also, improve geographic coverage and transparency of information on the registry system.

**Improve ease of paying taxes.** Develop e-payment system for taxation wherever possible to reduce time taken to file corporate and sales tax to Hacienda.

**Improve access to reliable and affordable electricity.** In addition to the above streamlining and digitization initiatives for receiving permits, see Chapter 9 (Energy and Power Regulatory Reform) for further structural reforms to improve reliability.

### *8.3.2 Invest Puerto Rico (iPR) and Discover Puerto Rico (DPR)*

The Government should plan to make iPR and DPR fully operationalized by the end of FY2018, and to ensure effectiveness, each organization should set specific targets and a plan to evaluate progress.

**iPR** should begin tracking data (both inputs and outcomes) to inform decision-making—for example, to predict and assess project ROI before providing funds or discontinue projects that are not driving results based on formalized project tracking. Further, iPR should publish quarterly or annual reports, addressing key metrics and any underperformance; hold regular (e.g., quarterly) board meetings; and track/course-correct projects on an ongoing basis, including incorporating feedback from investors and data trends.

**DPR** should track tourism statistics in Puerto Rico and compare to other tourism industries worldwide.<sup>56</sup> To determine its own standing, it should conduct regular visitors' surveys to assess satisfaction and quality of tourism services and strive for continuous improvement. Further, DPR should publish quarterly or annual reports addressing key metrics and any underperformance and should also update on targets, course-correct, and incorporate visitor feedback on an ongoing basis.

## **8.4 Implementation and enforcement of Ease of Doing Business reform**

To achieve the New Fiscal Plan's growth projections, ease of doing business reforms must be implemented immediately, with targeted operationalization of most initiatives by FY2019 (**Exhibit 31**).

A full set of expected milestones are below. The Government must fulfill these milestones in order to be compliant with the New Fiscal Plan and to give the Oversight Board confidence that they are able to hit relevant savings and growth targets. Without such reforms, the revenue that would be lost over the time of New Fiscal Plan would need to be found elsewhere in the budget.

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<sup>56</sup> For example, utilizing the Tourism Satellite Account tool leveraging economic tourism data

EXHIBIT 31: EASE OF DOING BUSINESS REFORM KEY IMPLEMENTATION MILESTONES

Areas of focus	Action item	Deadline
Streamline / Digitize Business Processes	• Complete design and initial launch of SUI	June 30, 2018
	• Ensure 100% integration into SUI for (i) licenses, (ii) cases filed, (iii) cases issued, (iv) concerned entities, and (v) autonomous municipalities	December 31, 2018
	• Complete process digitization (e.g., SUI, property registration)	June 30, 2019
	• Publish annual report on use of SUI	June 30, 2020
	• Monitor and continually improve systems	Ongoing
Reform Regulation (Occupational Licensing, Freights, Condo Law)	• Finalize plan for regulatory reform	June 30, 2017
	• Draft and pass legislation (as needed)	June 30, 2018
	• Announce implementation of regulatory reforms (e.g., join stateside occupational licensing agreements)	June 30, 2019
	• Conduct annual review of regulation and review potential	June 30, 2020
	• Announce updated regulation plan	June 30, 2022
Reform Permitting and Licensing	• Hold quarterly stakeholder outreach meetings with affected sectors to solicit feedback and fine-tune regulatory environment	Ongoing
	• Plan procedure, requirement, and time consolidation	March 31, 2018
	• Begin implementation of procedure, requirement, and time consolidation	March 31, 2018
	• Complete passage of any necessary legislation	March 31, 2019
	• Complete implementation of procedure, requirement, and time consolidation	December 31, 2020
Monitor Key Doing Business Rankings	• Conduct annual review of permitting and licensing	Ongoing
	• Hold quarterly stakeholder outreach meetings with affected sectors to solicit feedback and fine-tune regulatory environment	Ongoing
	• Designate Government representative(s) to be project manager with responsibility for driving DB ranking improvements	September 30, 2018
	• Request meeting with World Bank representatives to better understand Doing Business ranking methodology and solicit feedback on areas for improvement	December 31, 2018
	• Achieve target of EODB rankings	June 30, 2023
Invest Puerto Rico (iPR)	• Monitor annual performance in Doing Business rankings	Ongoing
	• Conduct CEO search and onboarding	September 30, 2017
	• Staff team and complete contracts	November 30, 2017
	• Complete strategic plan	January 31, 2018
	• Ensure ready to go live	March 31, 2018
Discover Puerto Rico	• Fully operationalize iPR	June 30, 2018
	• Develop and implement a performance monitoring framework (i.e., KPIs, interim milestones, etc.)	June 30, 2018
	• Publish first annual report	June 30, 2019
	• Recreate strategic plan	June 30, 2022
	• Track key metrics of success	Ongoing
	• Conduct CEO search and onboarding	September 30, 2017
	• Staff team and complete contracts	November 30, 2017
	• Complete strategic plan	January 31, 2018
	• Ensure ready to go live	March 31, 2018
	• Fully operationalize DPR	June 30, 2018
	• Develop and implement a performance monitoring framework (i.e., KPIs, interim milestones, etc.)	June 30, 2018
	• Refresh strategy and marketing plan for Puerto Rico	January 1, 2021
	• Implement new plan	June 30, 2021
	• Track key metrics of success	Ongoing

## Chapter 9. ENERGY AND POWER REGULATORY REFORM<sup>57</sup>

Over the next five years, the power sector in Puerto Rico must be transformed and modernized to support the delivery of reliable and affordable power. The Commonwealth must implement regulatory reform to enable a successful transformation and the resulting growth that the New

<sup>57</sup> Although the FOMB does not consider and has not considered anything in the New Fiscal Plan as a “recommendation” pursuant to Section 205(a), to the extent that the Government of Puerto Rico considers or has considered anything in this chapter a “recommendation” pursuant to Section 205(a), the FOMB hereby incorporates it into the New Fiscal Plan pursuant to Section 201(b)(1)(K)

Fiscal Plan projects. As detailed in the New Fiscal Plan for PREPA, the goal of the transformation of the power sector is to provide the citizens of Puerto Rico with low-cost, reliable, and resilient power delivered by an efficient and financially sustainable utility. The pillars of this transformation include restructuring the power generation mix to leverage low-cost sources of power, rebuilding and modernizing the power grid, implementing an operational cost transformation, executing a large-scale capital investment program with federal funds and private sector investments, restructuring the power industry by bringing in private operators, and establishing a new rate structure to allocate costs fairly and equitably across customers.

A strong and independent regulator of the power sector is required and will additionally support the success of the power sector transformation. Clear oversight authority should provide certainty throughout the process and should provide potential investors with confidence in the appropriateness of rate structures and the overall stability of the power sector in Puerto Rico. Furthermore, the long-term sustainability of Puerto Rico's energy sector depends on having a strong, independent, and professional regulator.

## **9.1 Current state and vision for energy reform**

The current regulator of the power sector in Puerto Rico is the Puerto Rico Energy Bureau (PREB). The PREB has the responsibility to "regulate, monitor and enforce the energy public policy of the Commonwealth of Puerto Rico" as provided by a single public monopoly provider.

Under a future transformed power sector in Puerto Rico, the PREB will continue to have these responsibilities as it applies to regulating, monitoring, and enforcing the energy policy of the Commonwealth of Puerto Rico, acting as the regulator for all participants in the energy sector.

The ideal regulator for Puerto Rico shall be modelled off the traditional Public Utilities Commission model used to oversee mainland U.S. utilities. The regulator shall be independent of the Government and operate under public service ethics and conduct rules. The regulator should have autonomy in decision-making and the authority to approve the Integrated Resource Plan (IRP), regular rate cases at two- or three-year intervals or through a formulaic rate mechanism and/or flexible rate case intervals consistent with the New Fiscal Plan.

### ***9.1.1 Structure of and funding for the Puerto Rico Energy Commission***

In line with best practices for regulatory commissions (e.g. California Public Utilities Commission, Hawaii Public Utilities Commission, New York Public Services Commission), the PREB should be headed by 5 commissioners who serve staggered 6-year terms. The commissioners should be appointed based on their technical, professional and/or academic credentials, with potential candidates being identified and appointed through a candidate list developed by a professional recruitment firm. The commissioners should be supported in their oversight role by a professional civil servant staff that has utility expertise. PREB shall develop and implement a plan for transitioning from its existing employee structure to a structure comprised of no less than 75% civil servant (career) employees and no more than 25% trust employees. This transition should be achieved no later than the end of FY2021. On or before March 15, 2019, PREB shall provide to the Oversight Board a report detailing PREB's proposed organizational structure, which shall be compliant with the aforementioned employee structure, and the proposed implementation plan for achieving said optimal employee structure by the end of FY2021. Both, during and after the energy sector reform process, PREB shall have sufficient staff to effectively undertake its duties and responsibilities in a timely and professional manner.

All commission decisions in adjudicatory proceedings should comply with the traditional requirements of administrative procedure. Separate from the regulator, there shall be an independent ratepayer advocate, a role currently filled by the Oficina Independiente de Protección al Consumidor (OIPC).

PREB shall be funded through the same mechanism as mainland regulators, with financing provided through rates, as independent funding for a strong regulator should be the best ROI for customers to protect their interests, increase transparency, and reduce system costs. Dedicated funding for power sector regulation should be prescribed in the charter legislation. PREB's budget should be increased to bring Puerto Rico in line with other similar jurisdictions. Beginning in FY2020, PREB's budget shall be increased to \$20-\$30 million dollars<sup>58</sup>. PREB's budget and funding shall be kept separate and independent from the Commonwealth budget or the budget of any other Commonwealth agency, entity or instrumentality, and neither the Executive nor the Legislative branches shall have authority to modify PREB's budget or reapportion any of PREB's funds without PREB's prior consent.

Funding for the OIPC shall be derived, primarily, from the funding allocated to PREB, in an amount that shall not exceed 10%. The OIPC may request, and be entitled to receive, additional appropriations from the General Fund or from other additional sources.

### *9.1.2 Mandate and authorities for the strengthened regulator*

To be effective, PREB must have a clear mandate to deliver reliable, safe power at an affordable cost. Accordingly, PREB shall have the following tools and authorities:

- Review and approval of rate cases filed by the electric service companies, including ability to mandate target rates and the use of rate structure and design tools that create predictability, minimize risk and “rate shock”, and create incentives to support equitability, economic development, and economically efficient rate designs
- Evaluation and approval of an electric service company's performance, establishment of appropriate performance incentives and total compensation structures, including a reasonable, market-based return on equity
- Review and approval of integrated resource plans, which will guide generation and capacity needs; approval of purchased power agreements and other contract terms; and issuance of Certificate of Public Convenience and Necessity (CPCN) for individual generators
- Support for and integration of renewables, distributed generation and new energy technologies as appropriate and consistent with the New Fiscal Plan for PREPA (e.g., through IRP process and enforcement of applicable renewable portfolio standards)
- Mechanisms providing for efficient enforcement of final orders and determinations
- Solicitation of input from public related to rates, IRP, and transformation process, with such input to be shared with the Oversight Board while it is in existence

## **9.2 Regulatory reform implementation and transition**

To enable the power sector transformation, the transition to a stronger regulatory structure must occur immediately.

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<sup>58</sup> Estimate in line with other jurisdictions; the Hawaii Public Utilities Commission had revenues of \$19M in FY2017 to serve a population of 1.4 million. \$7.6 million annual funding is assumed for PREB in the Commonwealth budget with \$5.8 million of that amount collected from yearly contribution made by PREPA and \$1.8 million collected from all other electric power service companies; the New Fiscal Plan for PREPA assumes \$20 million annual funding through rates beginning in 2020.

The details of the future-state regulatory framework should be designed by a working group comprised of experienced, professional, and impartial organizations and individuals.

However, during the transition period before the transformation takes place, the role of the Oversight Board with respect to energy sector regulation should be as follows based on its rights, powers, and duties in PROMESA:

- *IRP*: The Oversight Board approves revenue requirements and expenditures, including a capital plan, in the New Fiscal Plan for PREPA. The IRP process should be informed by and based on the New Fiscal Plan as additional data and more details on the capital plan and revenue requirements become available.
- *Budget and rate-making*: The Oversight Board approves a yearly budget that aligns with the New Fiscal Plan for PREPA and thus should align with revenue requirements and expenditures.
- *Utility debt*: The Oversight Board approves restructuring of existing debt through the Plan of Adjustment for PREPA.
- *Transformation*: As the representative of PREPA in Title III, the Oversight Board has the exclusive right to file a plan of adjustment, which will contain the transformation agreements.

The role of the PREB during the transition period should be as follows:

- *IRP*: PREB will approve the IRP. The IRP should test the scenario and alternatives in the New Fiscal Plan to achieve the principles of affordable, reliable and secure power. PREB should ensure that the IRP process is open and transparent so that third parties can understand inputs and methodologies behind each scenario and be able to participate and attend hearings to understand tradeoffs and decisions driving approval of the final capital plan and revenue requirement.
- *Budget and rate-making*: PREB shall authorize rates (either formulaic or on an expedited manner) which align with the budget as certified by the Oversight Board.
- *Utility debt*: No additional authorities because debt service implied by the current rate case will be superseded by the Oversight Board-approved budget and Plan of Adjustment.
- *Other*: PREB will continue to exercise its duties and responsibilities as outlined in its enabling laws except when doing so is inconsistent with the powers and authorities delegated to the Oversight Board under PROMESA.

Following the transition period, the regulator should be fully funded with the powers and authorities outlined in *Section 9.1.2*. The Oversight Board shall retain its powers as long as PREPA remains a covered entity under PROMESA.

Regulatory reform is necessary for the successful transformation of the power sector and PREPA.

### **9.3 Implementation and enforcement of energy and power regulatory reform**

To achieve the New Fiscal Plan's savings projections, energy and power regulatory reform must be implemented immediately according to the schedule described in **Exhibit 32**. The Government must fulfill these milestones in order to be compliant with the New Fiscal Plan and to give the Oversight Board confidence that they are able to hit relevant savings and growth targets. Without such reforms, the revenue that would be lost over the time of New Fiscal Plan would need to be found elsewhere in the budget.

EXHIBIT 32: ENERGY AND POWER REGULATORY REFORM KEY IMPLEMENTATION MILESTONES

Areas of focus	Action item	Responsible party	Deadline
Reform regulations	▪ Provide interim feedback on Integrated Resource Plan (IRP)	PREB	August 14, 2018
	▪ Remove CW government approval needed for PREB staff appointments	CW Government	December 17, 2018
	▪ Appoint the remaining PREB commissioner to serve staggered six-year terms	CW Government	Ongoing
	▪ Develop and establish regulatory framework as described in Law 120-2018	CW Government	December 17, 2018
	▪ Revise charter legislation to provide dedicated funding for power sector regulation that provides regulator with annual budget of \$20 million in line with benchmark	CW Government	December 31, 2018
	▪ Increase number of PREB staff in line with appropriate benchmarks	PREB	May 15, 2019
	▪ Increase percentage of technical, managerial, and administrative staff to match appropriate benchmarks	PREB	May 15, 2019
Transform PREPA	▪ Become cash-flow positive on a month-by-month basis	PREPA	Ongoing
	▪ Decrease operational costs by implementing operational efficiency measures	PREPA	December 31, 2019
	▪ Repay all outstanding AR balances to PREPA	PREPA/CW Government	December 31, 2019
	▪ Enforce revised CILT program	PREPA/PREB/CW Government	December 31, 2019
	▪ Host IRP filing with PREB	PREPA	January 31, 2019
	▪ Improve generation costs by switching to low-cost, clean, and resilient F&PP	PREPA	Ongoing through June 30, 2023
	▪ Decrease rates to below 20c in line with conclusion of transformation	PREPA	Ongoing through June 30, 2023
	▪ Reduce SAIFI and SAIDI in line with comparable benchmarks by developing a modernized, resilient, reliable grid	PREPA	Ongoing through June 30, 2023
Conduct transaction	▪ Perform market sounding to collect feedback on interests and concerns from interested parties	FOMB, P3	Ongoing
	▪ Initiate due diligence phase and provide requested information from bidders	FOMB, P3	Ongoing
	▪ Select winning bidder for T&D concession	FOMB, P3	September 25, 2019
	▪ Close transactions (i.e., generation asset privatization, T&D concession)	FOMB, P3	April 30, 2020

One of the power measures identified by PREPA to strengthen the utility's financial position and ultimately lower rates has been the reform of the CILT (contributions in-lieu of taxes) program.<sup>59</sup> PREB has approved a pass-through rider to fund the revised CILT program. PREPA, PREB and the Commonwealth should collaborate with municipalities and other stakeholders to implement and enforce the revised CILT program. Efforts should be made to ensure compliance with the program, whereby municipal power consumption counted towards a contribution in-lieu of taxes (effectively power exempt from payment) is capped at an agreed level and PREPA is reimbursed for any power sales to municipalities above the established cap.

<sup>59</sup> PREPA fiscal plan, section VIII

The Commonwealth should as soon as possible make payments for ~\$150 million<sup>60</sup> of outstanding AR to PREPA and continue to pay its power bills on a timely basis by ensuring any future AR balances are budgeted for. The Government must work with other agencies to ensure any other outstanding ARs are repaid to PREPA in a timely fashion.

## Chapter 10. INFRASTRUCTURE REFORM AND CAPITAL INVESTMENT

Relative to the mainland U.S., Puerto Rico's infrastructure outcomes rank near the bottom in quality and operating performance. In particular, poor transport infrastructure has contributed to congestion and thus impacted the ease of doing business on the Island. The capital investments enabled by post-Maria federal recovery funding offer a unique opportunity to make transformational investments that support economic development. This moment is unique as FEMA has expanded overall flexibility and willingness to support more transformational investments under Section 428 (under Title IV of the Stafford Act).

### 10.1 Current state of infrastructure and capital investment

Infrastructure investment as a percentage of GDP decreased from 3.3% in 2000 to 1.4% in 2014<sup>61</sup>, indicating a lack of recent experience in large-scale building. The Government also has a history of failed large-scale projects. For example, Tren Urbano was scheduled to open on July 1, 2001 after beginning construction in 1996; it finally opened in 2005 and the budget for the project increased more than 60%, from \$1.38 billion to \$2.25 billion.

In addition to the challenges with infrastructure delivery and maintenance, the poor state of transport related infrastructure is a key constraint on mobility. Puerto Rico is ranked 51st out of 52 (states + DC + PR) for quality of roads and is ranked 45th out of 52 (states + DC + PR) for congestion of roads<sup>62</sup>. Urban congestion is a particular problem in San Juan and on major highways. San Juan is in the top 15% of most congested cities worldwide, according to the 2017 INRIX Traffic Scorecard. It incurs daily delays of ~54,000 hours on average, costing ~\$165 million annually in commuter cost, without including the impact of congestion on the transport of goods, or the costs of unreliability or lack of safety.

Improving traffic on major highways along which goods travel, such as PR-52 and PR-18, is critical to enhancing growth. A 25% reduction in congestion can reduce travel cost by over 6% (NCHRP Report 463). Investments to reduce congestion should prioritize the most economically important trips, or provide alternative travel capacity to enable access despite congestion (Sweet, 2013). Targeted investments, such as "smart intersections", dynamic tolls and reversible lanes using movable barriers will reduce delays on key routes and journeys, and facilitate economic growth<sup>63</sup>.

Meanwhile, there are several critical elements that Puerto Rico should include to capitalize on the transformational opportunity afforded by historic federal capital funding.

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<sup>60</sup> As of end of June 2018 reporting

<sup>61</sup> Puerto Rico Planning Board

<sup>62</sup> U.S. Bureau of Transportation Statistics

<sup>63</sup> See, Jamal Haidar, "The impact of business regulatory reforms on economic growth," *Journal of the Japanese and International Economies*, Vol 26, 2012, pp. 285-307. In addition, there are several studies that review the impact of decongestion of roads on growth. Two examples are: New Zealand Institute of Economic Research, *Benefits from Auckland road decongestion*, July 2017, and Clifford Winston and Quentin Karpilow, *A New Route to Increasing Economic Growth Reducing Highway Congestion with Autonomous Vehicles*, Mercatus Working Paper, January 2017

- a) **Build organizational structures and capabilities** in the Government to prioritize and deliver projects faster and at lower cost;
- b) **Prioritize projects with the highest long-term benefit-cost ratios** taking account a variety of monetizable and non-monetizable benefits; and
- c) **Systematically leverage private sector capabilities** to improve overall public outcomes

## 10.2 Organizational structures and capabilities

When creating a reconstruction plan, it is imperative to build a central capability with the skills and mandate to design an overall recovery portfolio and oversee efficient project delivery. As such, the Government created the Central Recovery and Reconstruction Office (CRRO) as a Division of the P3 Authority to lead the coordination, development, and execution of long term recovery and reconstruction efforts. The CRRO has been created based on leading practices used in many jurisdictions, including New Jersey, Louisiana, New York and New Zealand, to ensure higher accountability, transparency and coordination of disaster recovery efforts.

The CRRO should commit itself to a decision-making framework that incorporates not only the degree of damage, but also the future level of service required from the asset and future risks to that asset, when deciding how that asset should be rebuilt. New York and New Jersey received ~\$10 billion in Section 428 funding post Hurricane Sandy, which decreased their vulnerability and helped ensure that capital dollars spent then did not simply have to be re-spent cleaning up after the next storm. The CRRO should aggressively pursue next level resiliency activities with federal dollars, to ensure that Puerto Rico's critical assets are sufficiently protected from future hazards.

Specific CRRO activities should include:

- Developing, presenting and administering recovery action plans
- Financing, executing and effecting infrastructure projects related to recovery efforts
- Monitoring contracting for compliance and effectiveness purposes
- Implementing and enforce checks and balances for procurement and approval of contracts and payments
- Coordinating and channeling all efforts and activities of the Government related to recovery efforts
- Monitoring capital project delivery, focused on major projects, to ensure on-time, on-budget delivery, highlight risks of cost overrun or delay, and create transparency for overall capital program delivery, including recovery spending led by CRRO or another Commonwealth entity with capital delivery expertise

## 10.3 Prioritization and delivery

The Government should employ infrastructure delivery best practices (e.g. prioritization of projects for economic impact, fast-track permitting, procurement reform). These best practices improve efficiency and transparency and should be applied to all areas of infrastructure expenditure of the Commonwealth including: reconstruction, construction and maintenance of government owned assets, and procurement of infrastructure through public corporations and Public-Private Partnerships (P3s).

The Government should pursue five sub-strategies:

**Set Commonwealth infrastructure priorities to guide investment**

- Set target outcomes to guide prioritization of projects
- Develop clear, systematic cost-benefit analysis and quantitative scoring to prioritize projects based on return on public investment and the ability to implement

**Accelerate the pre-construction process**

- Identify opportunities for local review and permitting, for as many projects as possible, to avoid federal delays
- For projects requiring local review, revisit existing process to reduce hurdles, and ease of meeting them, wherever possible
- Where federal approval is needed, focus on: clarifying decision rights and confirming processes with all major stakeholders; harmonizing local processes to match federal processes and seeking waivers where applicable; ensuring transparency and clarity from Federal Government on where projects are in the pipeline; and utilizing Title V of PROMESA

**Build sustainable funding models and financing strategies**

- Leverage external capital, by expanding PPPs and access to federal credit (e.g., TIFIA) and grant (e.g., INFRA) programs
- Increase bankability, and eligibility for participation in a PPP by deploying monetary and non-monetary incentives (e.g., recyclability of proceeds from asset monetization, including monetization of Government-owned real estate to support the revenue models for PPPs)
- Provide support to de-risk greenfield investment (e.g., reduction of early stage demand risk)

**Promote procurement and delivery best practices**

For projects that receive Commonwealth funding, ensure such projects:

- Develop an aligned owner organization with streamlined processes (e.g., early procurement involvement, accountable owner team oversight)
- Build an effective contracting strategy (e.g., tailored bidding process and pricing models, change order management tools)
- Utilize advanced procurement tools and approaches (e.g., rigorous clean sheet models, quantified view of Total Cost of Ownership drivers)
- Implement lean construction and digital techniques

**Build the infrastructure of tomorrow**

- Identify innovative technologies (e.g., automotive transformations, drones, new tunnel creation methods, the Internet of Things) and develop a strategy to actively promote them (e.g., AV pilot test zones), or at least find a way to not stifle their development (e.g., job trainings for displaced workers)
- Critically evaluate major new investments against future trends, to avoid disruption by innovation (e.g., avoid the buildout of excessive parking given increase in shared mobility and growth of autonomous vehicles)

#### **10.4 Implementation of infrastructure reform**

The implementation timeline for infrastructure reform can be found below (**Exhibit 33**). The Government must fulfill these milestones in order to be compliant with the New Fiscal Plan and to give the Oversight Board confidence that they are able to hit relevant savings and growth targets.

EXHIBIT 33: INFRASTRUCTURE REFORM KEY IMPLEMENTATION MILESTONES

Measure	Milestone	Date
Central Office of Recovery, Reconstruction, and Resilience (COR3)	Finalize economic and disaster recovery plan	August 8, 2018
	Finalize monitoring program for compliance with procurement, contracting, and payment requirements	August 8, 2018
	Fully staff team and complete COR3 operational contracts	August 8, 2018
	Deploy a proven grant-management software system	August 8, 2018
	Coordinate and channel all efforts and activities of the Government related to recovery efforts	Ongoing
	Issue annual report on status of implementation of recovery plan	Annually, August 2019-2023
Set Commonwealth Infrastructure Priorities to Guide Investment	Set target outcomes to guide prioritization	December 31, 2018
	Develop clear, systemic CBA to grade projects	Sep 30, 2019
	Submit list of prioritized projects based on new methodology	December 31 2019, Ongoing
Accelerate the Pre-Construction Process	Conduct diagnostic of pre-construction process (i.e., key steps, parties involved, and bottlenecks / gaps)	December 31, 2018
	Identify initiatives based on lean best practices to accelerate pre-construction process and reduce time and cost to delivery	March 31, 2019
	Submit roadmap for initiatives to improve pre-construction process	June 30, 2019
	Identify opportunities for local project review	June 30, 2019
	Segment projects by funding source to accelerate delivery	March 31, 2019
	Revisit local permitting requirements (non-Title V)	June 30, 2019
	Implement improved federal interaction model	December 31, 2019
Build Sustainable Funding Models and Financing Strategies	Conduct diagnostic to identify opportunities to leverage external capital (e.g., level of PPPs and concessions relative to benchmarks), including high potential asset classes and assets	December 31, 2018
	Build capabilities and assign dedicated CRRO team member responsible for identifying and promoting FDI	September 30, 2018
	Undertake external capital raising strategy to execute on opportunities for specific assets	March 31, 2019
	Develop FDI promotion strategy (e.g., priority sectors, sources of investment) and execute initiatives to promote FDI	March 31, 2019
	Release annual reports on relative performance on FDI and opportunities to enhance	December 31 2019, ongoing
	Undertake project review to determine opportunities to increase bankability to attract private funds (e.g., increasing or creating new revenue streams, transfer risk)	December 31, 2018
Promote Procurement and Delivery Best Practices	Execute on strategy to improve project bankability for priority projects (large magnitude or high impact)	September 30, 2020
	Determine opportunities to improve use and adoption of more effective contracting strategies (e.g., CHICA)	December 31, 2018
	Develop toolkit to maximize efficiencies	March 31, 2019
	Identify and pilot new tools for improved procurement delivery (e.g., contractor rating, design-build contracts for targeted assets)	June 30, 2019
	Ensure tracking of procurement and project level performance and create performance and outcomes-based monitoring (e.g., rewards/penalties for meeting or missing time thresholds)	December 31, 2019
Build the Infrastructure of Tomorrow	Review impact of each tool based on data and iterate	June 30, 2020
	Identify resiliency upgrades to existing and new infrastructure	June 30, 2018
	Prioritize and invest in resiliency upgrades based on schedule	December 31, 2018
	Identify innovative technologies, promotion strategy	December 31, 2019
	Review potential disruption to various infrastructure investments and asset classes and create methodology or periodic review to determine how to promote investment in high growth areas and ensure limited investment in areas that will have lower benefit given trends	June 30, 2020
	Completion of dynamic toll viaducts by HTA	July 31, 2023
	Completion of dynamic toll lanes by HTA	July 31, 2023
	Completion of signal system improvements by HTA	July 31, 2023

## PART IV: Transforming government to better serve the Island

In addition to structural reforms, the Government must also implement fiscal measures to create a sustainable fiscal future for Puerto Rico. Fiscal reforms should reduce costs while maintaining or improving the quality of important services. The wide range of government efficiency initiatives shall target an increase in revenues through new and more efficient collections activities, while decreasing government expenditures by ensuring reasonable usage of resources. The measures include the following:

**Office of the CFO** (*Chapter 11*). The Office of the CFO, a function of Hacienda, (“OCFO”), will also be responsible for—and crucial to achieving—a variety of reforms to ensure the responsible financial stewardship of the Island’s resources. For example, through fiscal controls and accountability, the OCFO should provide oversight to reduce historical Special Revenue Fund (SRF) deficits and drive \$21 million in run-rate savings by FY2023.

**Agency Efficiencies** (*Chapter 12*). A new model for government operations will “right-size” the Government through agency consolidation and reduction and/or elimination of government services. It includes comprehensive reform initiatives in the Departments of Education, Health, Public Safety, Corrections, Hacienda / OCFO, and Economic Development, as well as consolidations and reductions within the long tail of other agencies. Agency efficiency measures must result in \$1,585 million in run-rate savings by FY2023.

**Healthcare Reform** (*Chapter 13*). Healthcare measures seek to reduce the rate of healthcare cost inflation through a comprehensive new healthcare model that prioritizes quality relative to cost, and must result in \$826 million in run-rate savings by FY2023, projected to grow with healthcare inflation.

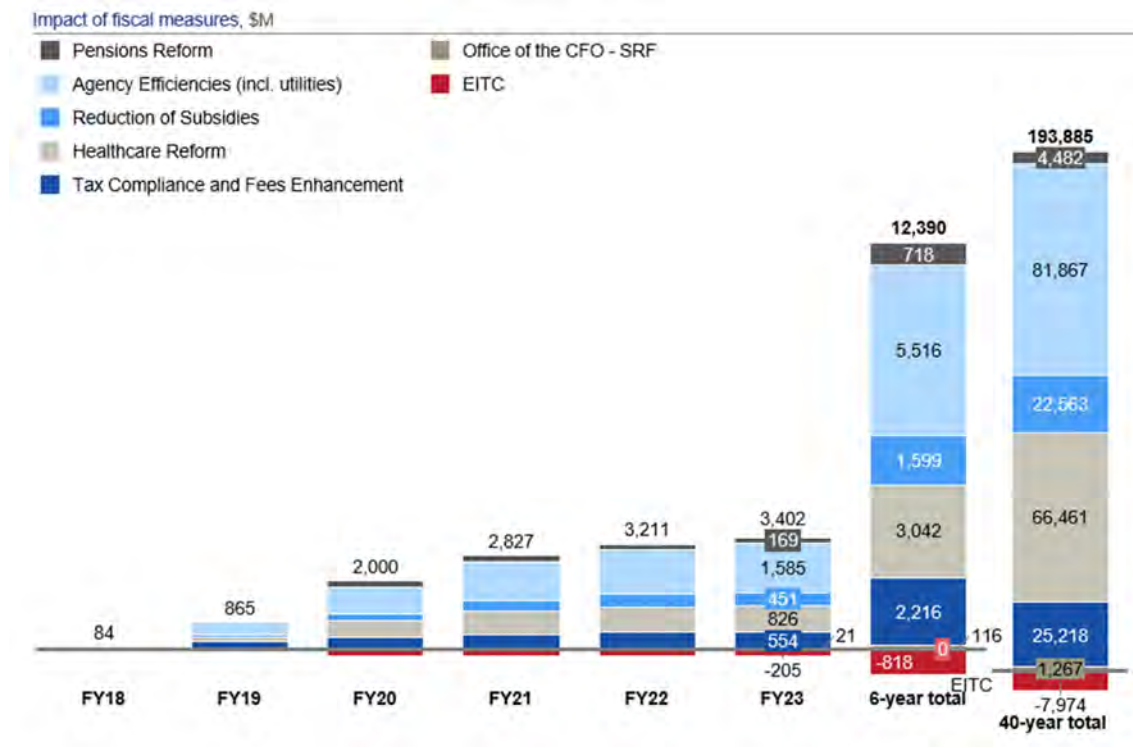
**Tax Compliance and Fees Enhancement** (*Chapter 14*). Tax compliance initiatives involve employing technology and other innovative practices, as well as implementing new taxes, to capture revenue from under-leveraged sources. These initiatives must increase run-rate revenues by \$554 million by FY2023.

**Reduction of Appropriations** (*Chapter 15*). The central Government will decrease appropriations granted to municipalities and UPR, which must result in \$451 million in run-rate savings by FY2023.

**Pensions Reform** (*Chapter 16*). Improvements to the financial stability of public employees’ retirement funds must result in \$169 million of run-rate savings by FY2023.

Together, these measures are crucial to the structural balance of Puerto Rico’s economy, and are projected to result in over \$12 billion in the next five years and over \$193 billion over the next 40 years (**Exhibit 34**).

#### EXHIBIT 34: IMPACT OF FISCAL MEASURES SAVINGS AND REVENUES



## Chapter 11. OFFICE OF THE CFO<sup>64</sup>

One of the highest priorities of the Government transformation will be the implementation of the transformed Office of the CFO. Despite attempts to better coordinate Puerto Rico's fiscal functions through Executive Orders 2013-007 and 2017-033, among other actions, the Government's current financial management functions remain decentralized, fragmented, obsolete, and in need of improvement. This must be solved by the establishment of a strong, centralized Office of the Chief Financial Officer for Puerto Rico ("OCFO") into the executive branch of Government. To date, the Government's actions related to the Office of the CFO have not driven toward this outcome, and Executive Order 2018-034 has led to an OCFO that is less independent than the reform initially intended.

By centralizing all financial management functions per the New Fiscal Plan, the OCFO would improve fiscal governance and forecasting, increase transparency, substantiate accountability, heighten internal controls, and improve stakeholder confidence in Puerto Rico's financial management. Most importantly, it will enable the Government to achieve fiscal responsibility and restore access to the capital markets, two cornerstones of PROMESA.

Core objectives of the OCFO must be as follows:

- A) Centralize treasury and liquidity management
- B) Enhance budget development process and improve monitoring / performance tracking

<sup>64</sup> Although the FOMB does not consider and has not considered anything in the New Fiscal Plan as a "recommendation" pursuant to Section 205(a), to the extent that the Government of Puerto Rico considers or has considered anything in this chapter a "recommendation" pursuant to Section 205(a), the FOMB hereby incorporates it into the New Fiscal Plan pursuant to Section 201(b)(1)(K)

- C) Drive standardization and integration of financial IT systems
- D) Ensure compliance with procurement, contracts, pensions, and human resources management policies
- E) Reduce special revenue funds deficits through enhanced control mechanisms and oversight
- F) Improve timeliness of CAFR (Comprehensive Annual Financial Report) and financial reporting
- G) Centralize and validate management of funds, debt, and other financial transactions

## **11.1 Responsibilities and actions of the OCFO**

### *11.1.1 Responsibilities*

To carry out the above objectives, the OCFO must be endowed with the following responsibilities:

- The OCFO shall act as the central authority over finance, budget, HR, audit, procurement, cash management, and debt issuance for all entities that receive support from the General Fund or otherwise depend on the Government's taxing authority
- The OCFO shall have the ability to remove any fiscal officer for violations of, or non-compliance with, the law, including failure to provide timely and accurate fiscal and financial information
- The OCFO shall oversee the transition to modified accrual accounting standards

To enable this level of centralized control, these functions must be consolidated under a single individual. The Governor has proposed that this person be the Chief Financial Officer, who will oversee the OCFO/Hacienda. Other offices can be merged into Hacienda and subsequently eliminated to create Hacienda / OCFO. These agencies include, but are not limited to: Treasury (consolidated, not eliminated), OMB, GDB<sup>65</sup>, AAFAF, OATRH, and GSA. All other fiscal functions of any departments, agencies, and instrumentalities that receive support from the General Fund or otherwise rely on the Central Government's taxing authority would all fall under the OCFO's authority.

#### **A) Centralize treasury and liquidity management**

- Enforce and manage a consolidated treasury single account for the Government; this involves consolidating visibility and control of all Government bank accounts, including CU accounts at private banks and creating a true Treasury Single Account. All other public entities should maintain zero balance sweep accounts
- Serve as the sole authority for new bank account creation and closure, as well as ongoing and ad-hoc liquidity reporting, monitoring and analysis. The OCFO must rationalize the bank account portfolio, optimize cash pooling/daily cash sweeps and treasury operations, and implement uniform accounts payable and disbursement prioritization policies, processes and reports

#### **B) Enhance budget development process and improve monitoring and performance tracking**

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<sup>65</sup> Scheduled to be liquidated

- Comply with the recently established Oversight Board budget guidelines and timeline to develop a budget that is consistent with the New Fiscal Plan and easily traceable to the New Fiscal Plan and the audited financials
- Forecast and manage receipt seasonality
- Oversee all tax decrees and tax agreements issues
- Operationalize the budget in the financial system to ensure consistency between accounts and facilitate monitoring of those accounts
- Estimate, protect, and enhance collections and revenue streams, and establish budgetary priorities and oversight, including effective expenditure controls and procurement reform

**C) Drive standardization and integration of financial IT systems**

- Drive the comprehensive upgrade and standardization of accounting and IT systems across all agencies

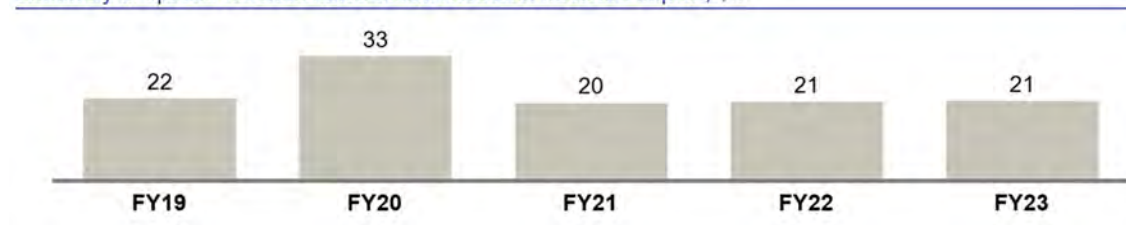
**D) Ensure compliance with procurement, contracts, pensions, and human resources management policies**

- Certify all contracts, bills, invoices, payroll, and other evidences of claims, demands or charges related to the central Government and all entities reliant on the Government's taxing authority, including prescribing forms of receipts, vouchers, bills and claims to be used by all agencies
- Manage centralized health insurance procurement and policy management
- Oversee human resources as well as all governmental payroll operations and all government-related financial transactions. The office must have the sole responsibility within the Government for reforming personnel policies, including the renegotiation of existing collective bargaining agreements ("CBAs") consistent with the New Fiscal Plan objective to achieve budget savings and efficiencies, ensure enhanced delivery of governmental services, and negotiate all future CBAs to achieve the same ongoing results
- Implement uniform time, attendance, and overtime processes and payroll controls and reporting

**E) Reduce special revenue fund deficits through enhanced control mechanisms and oversight.** Implement an additional measure to ensure responsible stewardship of Puerto Rico's Special Revenue Funds. Additionally, ensure all dedicated revenue streams attributable to SRF have their funds first deposited in the newly established Treasury Single Account. In this process, it will ensure a balance between current SRF revenues and expenditures to align with the legislative mandate that SRFs cannot outspend their resources (**Exhibit 35**).

EXHIBIT 35: SAVINGS GENERATED FROM ELIMINATION OF SPECIAL REVENUE FUND DEFICIT

Summary of special revenue funds deficit reduction measure impact, \$M



**F) Improve timeliness of CAFR and financial reporting**

- Establish a clear timeline to publish the FY2016 and FY2017 CAFRs and manage it to completion as soon as possible
- Implement a new process for the publishing of the FY2018 and subsequent CAFRs within the established regulatory timeframes, and drive improvements in the process and quality of the data provided. All releases should implement the modified-accrual basis of accounting as required in PROMESA and leverage the new forecasting, e-settlement, and analytics capabilities to support all OCFO functions
- Enact effective measures implementation forecasting and reporting
- Supervise property tax assessment reforms, prepare tax maps, and provide notice of taxes and special assessments

**G) Centralize and validate management of funds, transactions, and other financial transactions**

- Maintain custody of all public funds, investments, and cash, and administer cash management programs to invest surplus cash
- Facilitate long-term and short-term borrowing programs
- Maintain control and accountability over all funds, property, and other assets controlled or managed by the Government, and oversee all tax decrees and tax agreements issued
- Publish an annual Tax Expenditure Report that identifies and quantifies all tax expenditures (including all tax exclusions, exemptions, adjustments, deductions, subtractions, credits, abatements, deferrals, rebates and special rules.)

**11.2 Implementation and enforcement plan**

While Executive Orders can facilitate some of the initial reforms required, the OCFO's authorities should ultimately be established through a comprehensive statutory overhaul. Such legislation must conform to the New Fiscal Plan and PROMESA. **Exhibit 36** shows the milestones required to achieve the transformation and savings that the Oversight Board expects as part of the creation of the OCFO; further, the OCFO will be responsible for a number of implementation and fiscal controls / reporting, which is outlined in Chapter 17.

EXHIBIT 36: OCFO / HACIENDA KEY IMPLEMENTATION MILESTONES

Areas of focus	Action item	Deadline
OCFO Establishment	Draft and pass legislation (as necessary) in conformance with both the New Fiscal Plan and PROMESA	June 30, 2018
	Fully staff team to manage consolidation program	September 30, 2018
	Fully consolidate component agencies, including, but not limited to, (i) Treasury (consolidated, but not eliminated), (ii) OMB, (iii) GDB (until liquidation), (iv) AAFAF, (v) OATRH, and (vi) GSA, into OCFO	December 31, 2019
Fiscal Controls and Reporting	Submit revised forecast of General Fund net revenues for the current fiscal year based on actual revenues in the prior fiscal quarter (4Q FY2018) and notify the revision to the Director of the OMB, the Governor and the Oversight Board	August 15, 2018
	Publish all Government contracts and change orders in their entirety on the Office of the Comptroller's website	September 30, 2018
	Disburse 5% appropriations withholding based on actual revenue performance in the first six months of the current fiscal year (FY 2019)	April 1, 2019
	Update systems and reporting mechanisms	June 30, 2020
	Review controls and reporting and compare to best practices	Ongoing
Special Revenue Fund (SRF) Deficit Reduction	Enact policy that all dedicated revenue streams attributable to SRF must have their funds first deposited into the TSA	June 30, 2018
	Deploy enhanced SRF control mechanisms and oversight programs	June 30, 2018
	Implement processes to limit SRF expenditures based on expenses	June 30, 2018
Treasury and Liquidity Management Centralization	Consolidate visibility and control of all Government bank accounts, including Component Unit accounts at private banks	June 30, 2018
	Establish a true Treasury Single Account	June 30, 2018
	Enforce policy of zero balance sweep accounts at all other public entities	June 30, 2018
	Designate and empower the OCFO as the sole authority for new bank account creation and closure, as well as ongoing and ad-hoc liquidity reporting, monitoring, and analysis	June 30, 2018
	Rationalize bank account portfolio, optimize cash pooling/daily cash sweeps, and streamline treasury operations	September 30, 2018
	Implement uniform accounts payable and disbursement prioritization policies, processes, and reports	September 30, 2018
	Publish reports on ongoing accounts	Ongoing
Budget Development and Monitoring/Performance Tracking	Operationalize budget for current fiscal year (FY2019) in the financial system to ensure consistency between accounts and facilitate monitoring of those accounts	July 31, 2018
	Define reporting required annually	July 31, 2019
	Finalize system updates	July 31, 2022
Standardization and Integration of Financial IT Systems	Finalize plan for upgrade and standardization of accounting and IT systems	June 30, 2018
	Release RFP for proposed program	June 30, 2018
	Finalize and sign contract with selected vendor	September 30, 2018
	Fully implement upgrade and standardization of accounting and IT systems across all government agencies	June 30, 2019
	Conduct maintenance of IT systems	Ongoing
Procurement, Contract, Pension, and HR Compliance	Designate the OCFO as having sole responsibility for reforming personnel policies, including the (re)negotiation of all existing and future collective bargaining agreements (CBAs)	June 30, 2018
	Standardize forms for receipts, vouchers, bills and claims to be used by all government agencies	June 30, 2018
	Establish and manage a centralized insurance procurement and policy management system for all government agencies	September 30, 2018
	Implement uniform time and attendance processes, and payroll controls and reporting	December 31, 2018
	Complete annual procurement contract review	June 30, 2020
Improve Timeliness of CAFR (Comprehensive Annual Financial Report) and Financial Reporting	Complete ongoing compliance reporting	Ongoing
	Establish a clear timeline to publish the FY2015, FY2016, and FY2017 CAFRs and manage it to completion as soon as possible	June 30, 2018
	Implement a new process for the publishing of the FY2018 and subsequent CAFRs within the established regulatory timeframes (and using the modified-accrual basis of accounting required by PROMESA)	December 31, 2018
	Deploy forecasting and reporting tools to track progress and performance of implementation measures	December 31, 2018
	Publish report for FY19	December 31, 2019
Centralize and Validate Management of Funds, Debt, and Other Financial Transactions	Review of reporting process	Ongoing
	Establish and maintain OCFO custody of all public funds, investments, and cash	June 30, 2018
	Establish and maintain OCFO control and accountability over all funds, property, and other assets controlled or managed by the Government	June 30, 2018
	Enact cash management programs to invest surplus cash	September 30, 2018
	Publish an annual Tax Expenditure Report that identifies and quantifies all tax expenditures (including all tax exclusions, exemptions, adjustments, deductions, subtractions, credits, abatements, deferrals, rebates and special rules.)	September 30, 2018
	Publish annual reports on tax expenditure	Ongoing

## Chapter 12. AGENCY EFFICIENCIES<sup>66</sup>

### 12.1 Changes to agency operational expenditures

The Government has approximately ~116,500 employees<sup>67</sup> across 114 Executive Branch government agencies, as well as agencies within the Legislative and Judicial branches (excluding large instrumentalities, e.g., PREPA, PRASA, HTA UPR, COSSEC, GDB)<sup>68</sup>. With a total FY2018 budget of over \$9 billion, these agencies now utilize **personnel and non-personnel resources that are outsized compared to the actual service needs of the people of Puerto Rico**. Compared with states serving similar populations, Puerto Rico remains an outlier in terms of sheer number of agencies: for example, Iowa has only 36 state agencies and Connecticut has 78. In addition, there are countless examples of **subpar service delivery** across the Government. For instance, despite having 5+ agencies primarily dedicated towards the financial stewardship of the Island, the Government has been unable to report consistently accurate financial statements on a timely basis. In addition, Puerto Rico's education system has consistently delivered unsatisfactory student outcomes, including below-U.S. mainland graduation rates and standardized test scores are far below basic proficiency.

The level of governmental spending in Puerto Rico has not seen any significant decline in recent years even though Puerto Rico's population fell by 12% from 2007 to 2017 (prior to Hurricanes Irma and Maria)<sup>69</sup>. In fact, **Puerto Rico remains an outlier in terms of the number of citizens employed by the state government**, with between 25-30% of those currently employed working for the government (e.g., in a "governmental position")<sup>70</sup>, which places Puerto Rico in the top 10<sup>th</sup> percentile of U.S. states for public sector employment<sup>71</sup>.

Therefore, the right-sized Government of the future should wherever possible reflect mainland U.S. benchmarks in terms of both number of agencies and size of agencies themselves to **deliver services in as efficient a manner as possible**. As part of the new Government model, the Government should **consolidate the 114 agencies into no more than 35 agency groupings and independent agencies**. In some cases, the consolidations are designed to better focus the competing efforts of multiple agencies, such as the Economic Development grouping which will consolidate eleven agencies into one. In other cases, the consolidations should serve to move services closer to citizens, such as the Healthcare grouping which will consolidate access points to important services like Medicaid. Furthermore, in cases where agencies will be left independent, fiscal measures will be applied to improve the quality of the underlying services, especially in the case of PRDE.

The Government should also implement energy efficiency initiatives that reduce its utility payments in line with mainland energy efficiency efforts such as the U.S. Federal Energy Management Program (FEMP).<sup>72</sup> Energy efficiency initiatives would include facility & fleet optimization (e.g., recycling), better procurement, and strategic investments, potentially using some federal funds on utility capital expenditure.

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<sup>66</sup> Although the FOMB does not consider and has not considered anything in the New Fiscal Plan as a "recommendation" pursuant to Section 205(a), to the extent that the Government of Puerto Rico considers or has considered anything in this chapter a "recommendation" pursuant to Section 205(a), the FOMB hereby incorporates it into the New Fiscal Plan pursuant to Section 201(b)(1)(K)

<sup>67</sup> Excludes transitory employees

<sup>68</sup> Excludes agencies which currently have \$0 operating budget and no employees

<sup>69</sup> United States Census Bureau

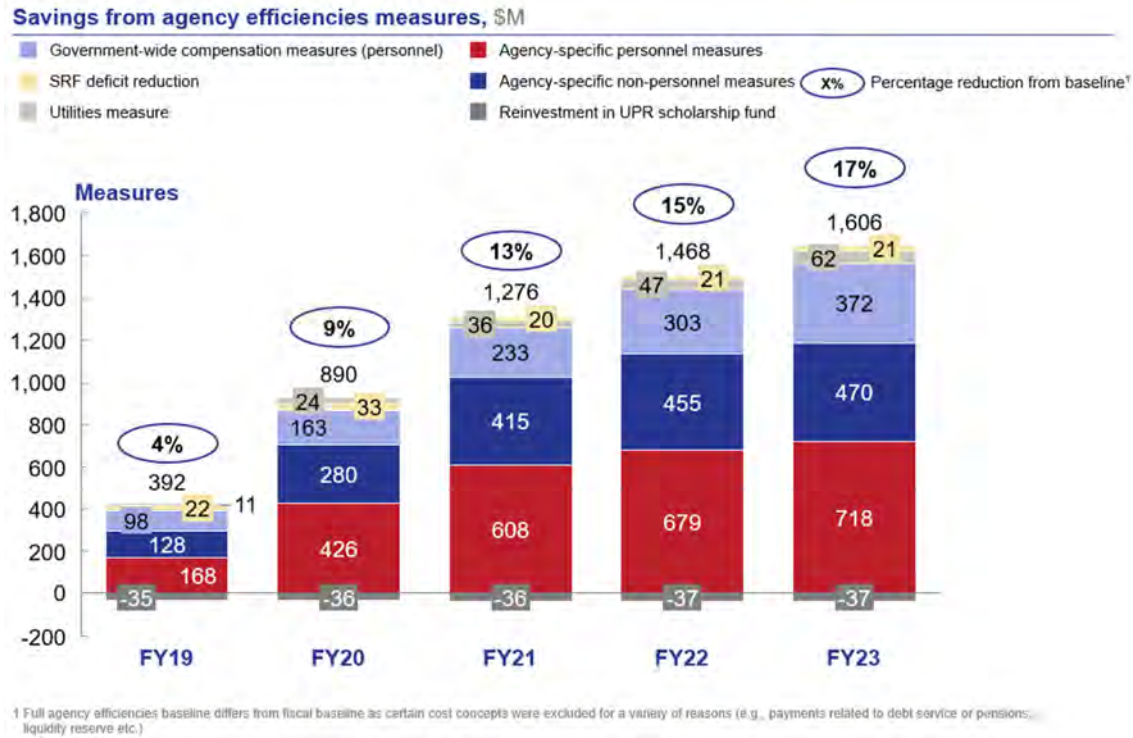
<sup>70</sup> Puerto Rico Economic Analysis Report 2015-2016 (PR Department of Labor and Human Resources)

<sup>71</sup> Gallup, "Gov't. Employment Ranges from 38% in D.C. to 12% in Ohio"

<sup>72</sup> Federal Energy Management Program <https://www.energy.gov/eere/femp/federal-energy-management-program>

In **Exhibit 37**, total savings from personnel, non-personnel, compensation and utilities measures are shown.

#### EXHIBIT 37: SUMMARY OF AGENCY EFFICIENCIES IMPACT



## 12.2 Approach to agency efficiency measures

There are several actions that have been applied to each agency to achieve these targets:

- **First, some agencies will be closed completely** if their function and programs are not required, resulting in a 100 percent personnel and non-personnel savings for all non-federal funded expenditures after a 2-3-year wind-down period (a minimum of 50% savings must be achieved no later than year 2).
- **Other agencies must be merged** when benchmarking and best practices determine that activities across agencies could be better served through a single mission and management to eliminate redundancies, and/or where economies of scale make shared services more economical without reducing quality of service.
- **A small subset of agencies will be left independent but made more efficient** through a series of streamlining efforts related to both personnel and operations, allowing the agency to provide existing services at a lower cost to taxpayers.

The Government proposed six agencies for closure: Model Forest; Culebra Conservation and Development Authority; Company for the Integral Development of Cantera's Peninsula<sup>73</sup>; Economic Development Bank; Industrial, Tourist, Education, Medical, and Environmental Control Facilities Financing Authority (AFICA); and National Guard Institutional Trust.

<sup>73</sup> To be closed on July 1, 2033 per current law.

### 12.3 Ensuring enforcement of the agency efficiency expenditure reductions

If, after any fiscal quarter the projected agency efficiency savings for any grouping is not realized, the shortfall from that fiscal quarter will be added to the agency efficiency savings target for the corresponding grouping for the following quarter.

**The Government shall produce a quarterly performance report**, which shall be submitted to the Oversight Board within 45 days of each fiscal quarter end, demonstrating the agency efficiency savings that have been realized, broken down by grouping and broken down between payroll and non-payroll savings, and displaying the performance of the realized agency efficiency savings for each grouping against the projections as set forth herein.

If, based on the quarterly performance reports and any other information the Oversight Board deems appropriate, the Oversight Board concludes there is underperformance in agency efficiency savings for any grouping, **the Oversight Board will take measures to enforce reductions in the amount of unrealized savings** in the following fiscal quarter for the corresponding grouping, reserving all rights under PROMESA, including but not limited to those under Section 201(e), Section 202(b), and Section 202(e), to do so.

As part of the agency efficiencies effort, **all consolidated agency groupings should perform a thorough review of the agencies within the grouping and submit a proposal for integration.**

The target savings methodologies are organized below (**Exhibit 38**).

EXHIBIT 38: SAVINGS TARGETS FOR AGENCY EFFICIENCIES

Savings targets, % off of baseline			
	Closing	Merging	Efficiency
Back-office	100%	40-50%	15-20%
Front-line	100%	Variable	Variable
Non-personnel operations	100%	30%	20%
Utilities reduction	15%	15%	15%

The Government has indicated that changes in proposed consolidations may occur in the future. Regardless of any changes, the Government shall still be accountable for achieving the total annual savings projected in this New Fiscal Plan.

However, the New Fiscal Plan recognizes that detailed agency-specific initiatives may require flexibility in which initiatives are applied to which agencies. As a result, the levers outlined above are highlighted as examples to achieve savings through efficiencies rather than directing all initiatives be taken by all agencies.

### 12.4 Compensation-related initiatives

#### Maintaining a payroll freeze

The Commonwealth Fiscal Plan certified in March 2017 included a measure to freeze all payroll expenditures which became law in FY2018. However, the freeze was due to expire at the end of FY2019. To extend the savings from freezing payroll increases, **the freeze must be continued** through the duration of the New Fiscal Plan. This measure should amount to \$274.0 million in annual savings by FY2023.

### **Standardizing healthcare provided to government employees**

Medical insurance is a core benefit provided to all government employees. However, the degree of coverage varies widely across government agencies, with some employees receiving superior coverage compared to their peers. For instance, Office of the Governor employees receive an average of only \$100 per month in medical benefits, whereas employees of the Housing Finance Authority receive more than \$1,000 per month<sup>74</sup>.

To ensure fairness and reduce expenditures, the Government must implement its proposal to **standardize the health insurance received by each employee so that everyone receives \$125 worth of benefits per month, or \$1,500 per year**; additionally, employees of public corporations should maintain preexisting conditions coverage. This initiative should have been fully implemented by the start of FY2019, and should lead to \$28.1 million in run-rate savings by FY2023.<sup>75</sup>

### **Reducing additional outsized non-salary compensation paid to employees**

There are several policies that the Government must continue to enforce through the duration of the New Fiscal Plan that will impact personnel spend. These include:

- Asserting a hiring freeze with stringent requirements for backfilling positions left open by attrition or workforce reduction
- Limiting paid holidays to 15 days annually across all public employees
- Prohibiting carryover of sick and vacation days between fiscal years
- Prohibiting any future liquidation of sick and vacation days
- Eliminating the Christmas bonus for all public employees

The hiring freeze policy was included in the March 2017 Fiscal Plan, and the New Fiscal Plan continues to enforce that policy while requiring the Government to propose stringent requirements for the backfilling of any opened positions for approval to the Oversight Board. The other policy measures outlined above were enacted in Act 26-2017, except for the elimination of the Christmas bonus. The elimination of the Christmas bonus is projected to lead to ~\$70 million in run-rate savings, starting in FY2019.

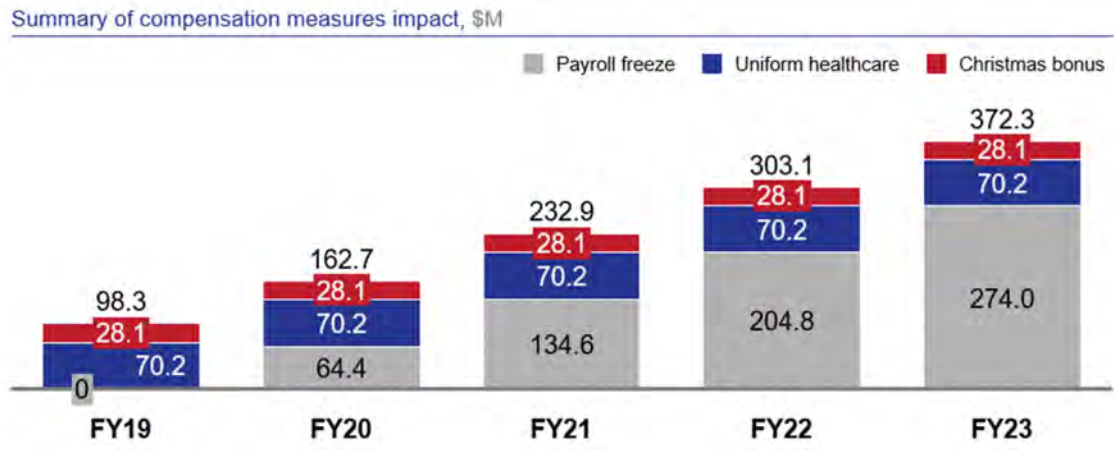
Total savings from compensation-related measures must achieve \$98.3 million in FY2019 and reach a run-rate of \$372.3 million per year beginning in FY2023. Annual savings targets are summarized below (**Exhibit 39**).

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<sup>74</sup> Analysis of active, non-transitory government employees not supported by Federal Funds; data provided within January 2018 Government attrition model

<sup>75</sup> This total excludes uniform healthcare savings from the PRDE and the DPS, both of which have been calculated independently and included in their respective sections of the New Fiscal Plan

EXHIBIT 39: COMPENSATION-RELATED MEASURES SUMMARY OF IMPACT



To achieve the New Fiscal Plan's savings projections, compensation-related measures must be implemented according to the schedule described in **Exhibit 40**.

EXHIBIT 40: COMPENSATION-RELATED MEASURES KEY IMPLEMENTATION MILESTONES

Areas of focus	Action item	Deadline
Payroll freeze	Pass legislation to freeze payroll for public employees through at least FY23	March 31, 2019
	Institute payroll freeze	June 30, 2019
	Review policy of payroll freeze	June 30, 2023
Eliminate Christmas bonuses	Pass legislation to eliminate the Christmas bonus	September 30, 2018
	Implement Christmas bonus phase out	December 1, 2018
Uniform Healthcare	Launch RFP for uniform healthcare	July 1, 2018
	Implement new contract	January 1, 2019
	Launch new RFP process	January 1, 2022
	New provider coverage operational	July 1, 2022

## 12.5 Department of Education (PRDE)

### 12.5.1 Current state and future vision for the Department of Education

Throughout the last decade, PRDE has encountered longstanding challenges which have contributed to low academic performance, including bureaucratic hurdles associated with operating as a single local education agency, inability to execute professional evaluations tied to quality outcomes in the classroom, and lack of a cohesive strategy for academic improvement.

In addition, PRDE, the largest agency in the central Government by spend, is outsized relative to need. While student enrollment has declined considerably over the past few decades (over

50% decline since its peak in 1980, and by about 33% in the past decade alone),<sup>76</sup> the number of schools and teachers has not decreased proportionally (with only about a 30% reduction in public schools since 1990).<sup>77</sup> With an expected additional student decline of ~15% over the next 6 years, PRDE has significant room to right-size its education system relative to number of students. Tightening its system will give PRDE the flexibility and funding to focus on improving the quality of education provided.

To improve the capabilities and capacity of the Puerto Rican population, the Government will need to set high aspirations. PRDE aims to improve student academic achievement by **reducing the achievement gap by 12% annually on Puerto Rico proficiency tests**, achieving 80% proficiency in Spanish, 73% in Mathematics, and 77% in English; and further, improving the graduation rate to 90% by FY2023. This mandate is not easy, but is attainable through a **series of education efficacy and efficiency measures as well as targeted reinvestment in student and teacher outcomes**.

#### *12.5.2 PRDE Efficiency measures*

PRDE must achieve \$35.6 million in personnel savings, \$13.1 million in non-personnel savings and \$0.6 million in SRF deficit reduction savings in FY2019. **Exhibit 41** shows the annual personnel and non-personnel savings that must be achieved through FY2023. To accomplish this, PRDE could consolidate its footprint (including schools, classes, teachers, and administration), modernize facilities, revise the curriculum, and equip teachers with what they need to succeed. Measures must generate \$576 million in run-rate savings by FY2023 inclusive of funds needed for requisite reinvestments to increase quality.

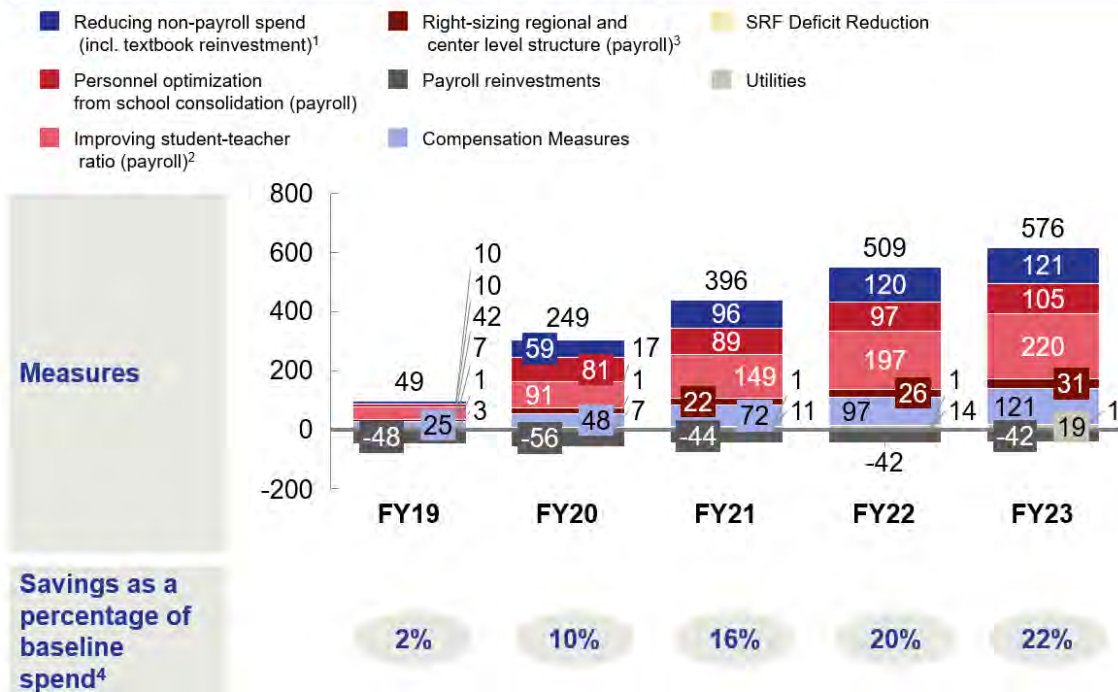
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<sup>76</sup> Helen F. Ladd and Francisco L. Rivera-Batiz, "Education and Economic Development in Puerto Rico" *The Puerto Rican Economy: Restoring Growth*, Brookings Institution Press, Washington, D.C., 2006, 189-238

<sup>77</sup> There were 1,619 public schools in 1990 and 1,131 at the time of reporting. Oversight Board Listening Session, Secretary Julia Keleher, "On the Road to Transformation," November 30, 2017

EXHIBIT 41: DEPARTMENT OF EDUCATION MEASURES SUMMARY OF IMPACT

Summary of Department of Education measures impact, \$M



<sup>1</sup> Includes school closure implementation costs

<sup>2</sup> Includes teacher and director salary reinvestment as well as all implementation costs

<sup>3</sup> Includes director salary increase

<sup>4</sup> Inclusive of all savings measures over baseline, i.e. savings measures attributable to Christmas bonus, payroll freeze, uniform healthcare, SRF reduction

*Reducing non-payroll spend through consolidating the K-12 school footprint and procurement*

PRDE has closed over 480 schools (30% of K-12 schools) since 1990. After SY2016-17, PRDE closed 167 schools,<sup>78</sup> and closed another 255 schools in SY2017-18.<sup>79</sup> After an analysis of several factors including capacity, geographic and cultural characteristics, distance to neighboring schools, transportation costs, and facility quality, among others, the Government has determined that it will be able to close a total of 307 schools before FY2020, or an additional 24 schools beyond this summer's planned closings, and it must do so. It should target an average capacity of 330 students per school for each primary school and 700 students per secondary school.

Each school closure should save an estimated \$47,000 annually by reduction of facility costs. Consolidation of schools will also enable higher quality outcomes at lower cost by enabling systems to invest in a smaller number of higher-performing schools.

Independent of, but accelerated through, consolidations, PRDE procured spend should be reduced by approximately 10-15% through centralized procurement policies including strategic purchasing and demand controls (see full set of procurement levers in *Section 12.2*).

*Personnel optimization from school consolidation*

<sup>78</sup> Puerto Rico Department of Education Report "Schools Closed FY2017." Accessed January 2018

<sup>79</sup> Puerto Rico Department of Education Press Release, March 2018

To date, school consolidations have not always led to proportional cost savings because they are often not accompanied with concurrent reductions in staff. Going forward, the number of school staff is expected to decline proportionally to the projected decrease in number of schools. For example, the number of school administration (principals, office staff, etc.), food service staff, facility maintenance staff, and other school-specific staff should be scaled down accounting for a smaller number of schools. This should achieve \$104.5 million in run-rate savings by FY2023.

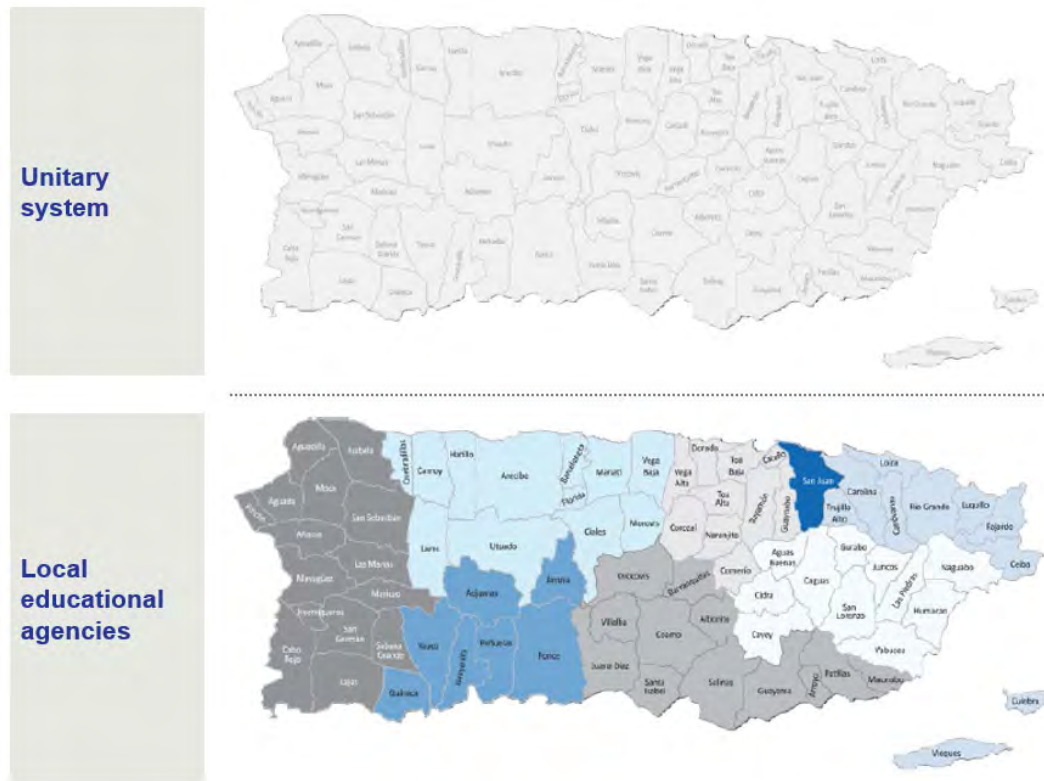
#### *Improving student-teacher ratio*

Puerto Rico's student-teacher ratio is currently 11:1, compared to approximately 16:1 in many comparable districts on the mainland such as Miami-Dade County Public Schools in Florida. Puerto Rico's student-teacher ratio will only continue to decrease with the projected student enrollment declines in the coming years. To address this, teacher staffing levels will be reduced to reach a target student-teacher ratio of 14:1. This ratio is slightly smaller than the mainland benchmark due to several constraints specific to Puerto Rico, such as its high proportion of special education students. These teacher-focused measures should achieve \$220.5 million in run-rate savings by FY2023, inclusive of transition costs under workforce reduction policies (e.g., liquidation of vacation pay). The savings figure is also reduced to reflect additional investment in increased salary for remaining teachers (detailed below).

#### *Right-sizing regional and center level structure*

Rather than function as a single Local Education Agency (LEA), PRDE should create regional LEAs (**Exhibit 42**).

#### EXHIBIT 42: LOCAL EDUCATIONAL AGENCIES FUTURE STATE REGIONS



This new regional LEA model will be leaner while also decentralizing the administration of individual schools, putting decisions closer to students and families and improving outcomes. Developing and relying on local leadership must also allow PRDE's central administrative structure to right-size to staffing levels comparable to state educational agencies (SEAs) in comparable mainland U.S. states. Currently, the central administration has one staff per 133 students projected in FY2022; the 50<sup>th</sup> percentile of U.S. states is a ratio of 1:166. A decentralized model also decreases dependency on the secretary's office for day-to-day decision making, building capabilities of second-line management at the regional level.<sup>80</sup>

Implementing the regional LEA model must allocate administrators more effectively for decision-making. The model should decrease headcount requirements at the regional level and central level; further, allocation of administrators in less costly regional centers (as opposed to centrally) should enable cost savings on retained positions. Each regional office is expected to have capable leadership and staff to execute core functions, including operations, student services, accountability, and academic standards. This model should achieve \$30.8 million in run-rate savings by FY2023 from less costly regional positions and reduced central staff, while seeking to improve PRDE operations and student outcomes.

### *12.5.3 Reinvestment in education outcomes*

The education of the children of Puerto Rico, and their successful entrance into the workforce, is a core goal of PRDE. Investment in education has also been shown to drive long-term economic growth – and in the case of Puerto Rico is projected to add 0.26% increase in GNP growth by FY2058 and keep growing thereafter (see *Section 4.2* for further discussion of GNP impact). As a result, it is important that some of the savings from education measures are reinvested to drive student and teacher outcomes. PRDE will drive two such initiatives, both funded through reinvesting right-sizing savings:

1. Teacher development and retention
2. New educational materials such as textbooks

#### *Teacher development and retention*

Teachers are considered one of the most determinative factors in student success in the classroom and standard of living beyond the classroom. For example, one U.S. study found that classes with an average-quality teacher had a lifetime income of \$266,000 higher than classes with a poor-quality teacher in each year.<sup>81</sup> Improved education through enhanced teacher quality is critical to the long-term success of the children of Puerto Rico and will help to lift a new generation of Puerto Rican citizens out of poverty. Recognizing this, PRDE has committed to transforming system practices related to attracting, retaining, and developing teachers and administrators:

1. **Providing increased opportunities for and higher quality of training** (e.g., in-class; through leadership academies; STEM development through collaboration with universities)
2. **Creating opportunities for targeted skill development** (e.g., instituting mentorship programs to enable coaching by experienced and high-performing teachers as a cost-neutral, and often high impact, initiative)
3. **Investing in teacher salaries that approach mainland comparators.** Teachers in Puerto Rico have not received a pay raise in nearly a decade, while salaries on the mainland

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<sup>80</sup> Oversight Board Listening Session, Secretary Julia Keleher, "On the Road to Transformation" November 30, 2017

<sup>81</sup> Raj Chetty, John N. Friedman, and Jonah E. Rockoff, "The Long-Term Impact of Teachers: Teacher Value-Added and Student Outcomes in Adulthood," National Bureau of Economic Research, 2011

consistently increase in keep up with cost of living. Salaries are significantly lower than mainland comparators, causing Puerto Rico to lose out on opportunities to attract and retain talent in its teacher and administrator positions. The Government will implement a \$1,500 annual salary increase for teachers<sup>82</sup> and has introduced a \$5,000 annual salary increase for principals (effective November 2018) to begin closing this gap, although the gap remains large, and incentivize retention of highest quality teachers.

These teacher-focused reforms will be funded through reinvestment of right-sizing measures and are factored into the overall savings measures as described above. Such reforms will have a dramatic impact on student outcomes not only in school but beyond, as students enter the workforce and lead a new generation in Puerto Rico.<sup>83</sup>

*New educational materials including new textbooks*

Teachers are currently limited in their ability to provide the best educational opportunities because of the limited resources available, including up-to-date textbooks. Therefore, \$75 per student (for FY2019-FY2021) will be invested in procuring new textbooks, or \$21-24 million each year as one-time costs. This will be funded through reinvestment of non-payroll savings created by measures, and is factored into the measure savings as described above.

*12.5.4 Implementation of reforms*

To achieve the New Fiscal Plan's savings projections, reforms within the Department of Education must be implemented according to the schedule described in **Exhibit 43**.

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<sup>82</sup> In 2016, mainland U.S. teachers earned an average salary of over \$58,000 (U.S. Department of Commerce, Bureau of Economic Analysis, National Income and Product Accounts, table 6.6D, August 2016). The average salary for a teacher in Puerto Rico (less benefits) is approximately \$32,000 per year. An increase of \$1,500 per year would bring average teacher salary to \$33,500, still approximately 42% lower than the mainland U.S.

<sup>83</sup> For example, reducing teacher absenteeism, which was found to reduce 4th-graders' math test scores by 3.2% of a standard deviation for every additional 10 days of teacher absence, could create a step change in student proficiency

EXHIBIT 43: DEPARTMENT OF EDUCATION GROUPING KEY IMPLEMENTATION MILESTONES

Areas of focus	Action item	Deadline
Optimize student-teacher ratio	▪ Outline clear pathway to achieving 33% progress to desired student-teacher ratio by end of FY19 (school closures and any other measures)	August 1, 2018
	▪ Publish number of teachers reduced through school closures	September 1, 2018
	▪ Outline further measures required to reduce teacher numbers	September 10, 2018
	▪ Complete measures to achieve target of 14:1	End of SY22
Enact school consolidations and closures	▪ Close 283 total schools	End of SY18
	▪ Develop transportation plan for relocated students	July 1, 2018
	▪ Ensure cancellation of auxiliary service contracts (i.e. food, maintenance) to capture savings and release non-teacher headcount reductions	August 1, 2018
	▪ Sell or reappropriate empty buildings	September 1, 2018
	▪ Publish report on cost savings achieved through school closures (non-teacher personnel and auxiliary services)	November 1, 2018
	▪ Publish plan for closure of further 24 schools	December 1, 2018
	▪ Implement closures of 24 schools	July 1, 2019
	▪ Review school requirements	Ongoing
Decentralize institutions and structure	▪ Established regional super intendancies	August 1, 2018
	▪ Pass legislation to formalize new structure	October 1, 2018
	▪ Merit-based Regional Leadership selection system in place	October 1, 2018
	▪ Regional superintendancies established and staffed	October 30, 2018
	▪ Publish plans for rightsizing the state educational agency (SEA)	October 30, 2018
	▪ Implement rightsizing plans	December 31, 2018
	▪ Review rightsizing plans	Ongoing
Achieve procurement efficiency	▪ Develop new centralized operating model for procurement	September 1, 2018
	▪ Identify major contract targets for savings	September 1, 2018
	▪ Release RFP for major services	October 1, 2018
	▪ Capture savings	November 1, 2018
	▪ Review procurement strategy	January 1, 2021

## 12.6 Department of Health (DOH)

### 12.6.1 Current state and future vision for the Department of Health

Currently, the Government has several health-related agencies that are highly fragmented: three public corporations, three public hospitals, seven sub-secretaries, six regional offices, and eight program offices administering 64 federally funded programs—all with their own support functions. Such fragmentation drives up cost and inefficiency, as each agency provides its own human capital management, procurement, and financial support. Citizen experience and care delivery also suffer as Puerto Ricans face multiple handovers of individual cases across frontline staff with fragmented focus.

In the future state, the Department of Health will involve consolidation of seven agencies with centralized support functions: The Department of Health (DOH); Medical Services Administration (ASEM); Health Insurance Administration (ASES); Mental Health and Addiction Services Administration; Puerto Rico and the Caribbean Cardiovascular Center Corporation; Comprehensive Cancer Center; and Center for Research, Education, and Medical Services for Diabetes (**Exhibit 44**). This new DOH should enable efficiencies while maintaining high quality public health. Consolidating these seven agencies should provide opportunity for right-sizing support functions, as well as centralizing procurement to provide savings on costly medical materials and equipment.

#### EXHIBIT 44: AGENCIES INCLUDED IN FUTURE STATE DEPARTMENT OF HEALTH GROUPING

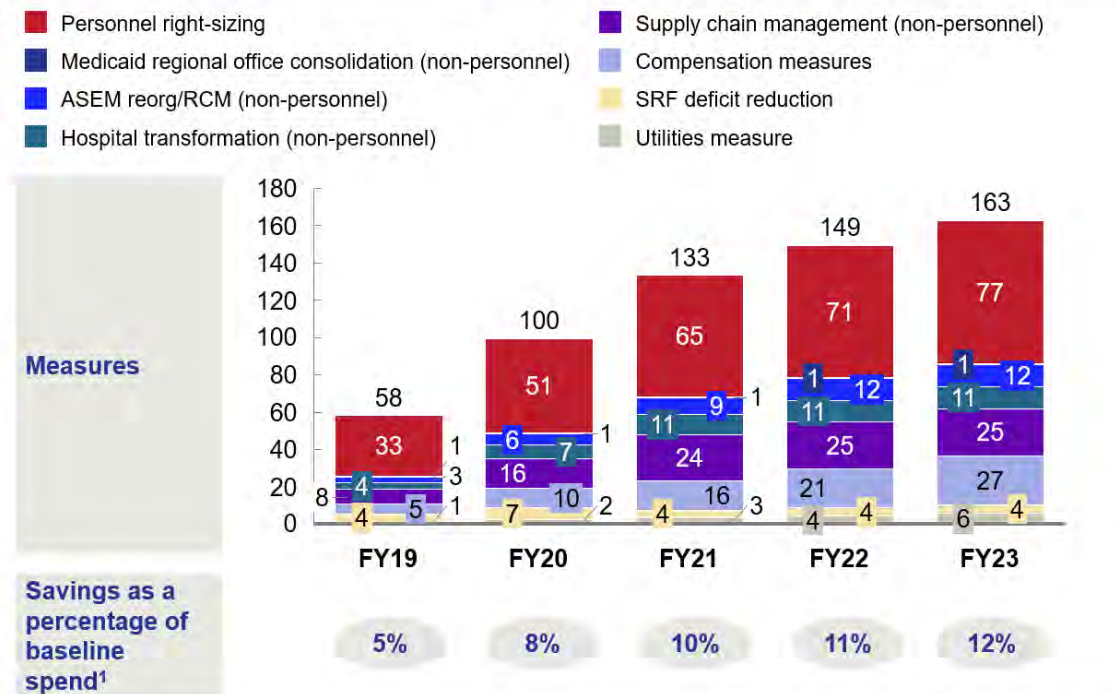
1 Department of Health	5 Comprehensive Cancer Center
2 Health Insurance Administration (ASES)	6 Mental Health and Addiction Services Administration
3 Medical Services Administration (ASEM)	7 Puerto Rico and the Caribbean Cardiovascular Center Corporation
4 Center for Research, Education and Medical Services for Diabetes	

### 12.6.2 Efficiency measures for the Department of Health

By bringing together seven major agencies to create the Department of Health (DOH), the Government must take advantage of personnel and non-personnel savings that can be achieved through consolidation. DOH must achieve \$37.8 million in personnel savings, \$16.0 million in non-personnel savings and \$4.5 million in SRF deficit reduction savings in FY2019. Refer to **Exhibit 45** for annual personnel and non-personnel savings that must be achieved through FY2023.

EXHIBIT 45: DEPARTMENT OF HEALTH MEASURES SUMMARY OF IMPACT

Summary of Department of Health measures impact, \$M



<sup>1</sup> Inclusive of all savings measures over baseline, i.e. savings measures attributable to Christmas bonus, payroll freeze, uniform healthcare, SRF reduction, utilities measure

*Personnel optimization and centralization*

The Government should centralize and consolidate support functions, including finance, HR, legal, revenue cycle management, procurement, grants management, and epidemiology. Improved management and oversight of these functions, and workforce reductions associated with consolidation, must result in \$76.8 million in run-rate personnel savings by FY2023.

*Medicaid consolidation and optimization*

Medicaid currently has 85 offices across 78 municipalities that can be consolidated into fewer, more strategic locations. Reducing the Medicaid office and regional hospital office structure will eliminate duplication of effort and redundancies—and allow the Department to provide more robust services at convenient locations. In addition, ASES will redesign the Medicaid eligibility and enrollment process (web based, MCO dependent, hospital responsibility, etc.) and encourage online services to improve data management. Best practices from the mainland include engagement of third-parties within hospitals to identify and enroll eligible patients into the Medicaid program.

Consolidation of regional centers and Medicaid optimization should result in \$0.5 million in run-rate savings by FY2023.

*Supply chain management*

Due to the large volume of spending on procuring medical supplies and equipment, and the high cost of such materials, there is a significant opportunity to improve procurement efficiency through best practice supply and demand management, and better employing economies of scale. In FY2018, there was over \$263 million in addressable non-payroll

spending (excluding any hospital expenditures) across all agencies. This measure to reduce non-payroll spend through procurement efficiency could amount to \$25 million run-rate savings by FY2023.

#### *Hospital management transformation*

In addition to other agencies' non-payroll savings, hospital transformation will likewise seek to improve procurement savings specifically for hospitals and health systems, which will focus on commodity standardization and sourcing, indirect spending (analyzing insourcing vs. outsourcing opportunities), and physician preference item optimization.

Holistic hospital transformation efforts should also reduce payroll spend through clinical labor optimization, which is captured in the "personnel optimization" measure. For example, wages should be optimized to fair market value to reduce turnover and therefore temporary/overtime spend; and role/responsibilities should be optimized to skill level and wage rate. This measure would result in \$11.5 million in run-rate savings by FY2023.

#### *Restructuring ASEM and Revenue Cycle Management*

ASEM is a public corporation originally created to serve as a central procurement office for government hospitals to create economies of scale for medical supplies, devices, and services. Throughout the years, rates, salaries, and services have increased at a higher rate than within the broader industry, and procurement processes have decentralized across the hospitals ASEM was created to serve.

The focus areas of this measure include: 1) Establishing a centralized Medical Center including ASEM, University, Pediatric and Cardiovascular hospitals; 2) Identifying and establishing key hospitals across the Island; 3) Designing and implementing a referral system among key hospitals and clinics; and 4) Establishing a physician network. Improvements will be made to personnel, process, and technology. This measure would result in \$12 million of run-rate savings by FY2023.

#### *12.6.3 Implementation of reforms*

To achieve the New Fiscal Plan's savings projections, reforms within the Department of Health grouping must be implemented according to the schedule described in **Exhibit 46**.

EXHIBIT 46: DEPARTMENT OF HEALTH GROUPING KEY IMPLEMENTATION MILESTONES

Areas of focus	Action item	Deadline
Consolidate agencies	▪ Pass legislation of merging entities	January 1, 2019
	▪ Complete system integration between agencies	June 30, 2019
	▪ Monitor merger progress	Ongoing
Rightsizing personnel	▪ Complete capacity analysis	September 1, 2018
	▪ Create new organizational plans	November 1, 2018
	▪ Create training program for employee transitions	January 1, 2018
	▪ Commence wave two of rightsizing	July 1, 2019
	▪ Assess rightsizing achievements and review strategy for date	July 1, 2021
	▪ Complete rightsizing	June 30, 2023
Consolidate regional Medicaid offices	▪ Identify branch inefficiencies and determine offices for closure, leaving centralized locations	November 1, 2018
	▪ Create plan for office closures	December 1, 2018
	▪ Implement closures	February 1, 2019
	▪ Monitor post-closure savings	Ongoing
Improve supply chain management	▪ Conduct thorough inventory of current procurement processes, suppliers, and process owners	October 1, 2018
	▪ Begin RFP process for vendors	November 1, 2018
	▪ Select vendor	December 1, 2018
	▪ Implement changes	February 1, 2019
	▪ Review current provider and issue new RFP	January 1, 2021
	▪ Launch new provider contract	July 1, 2021
	▪ Monitor savings	Ongoing
Transform hospital management	▪ Identify opportunities for process standardization (procurement, outsourcing of tasks, technology integration)	October 1, 2018
	▪ Build plan including creating workflows and standard policies based on best practices by practice area	December 1, 2018
	▪ Redesign evaluation criteria based on best practices and outcomes	December 1, 2018
	▪ Review current operations and build new map strategy	January 1, 2022
	▪ Implement new system	June 30, 2022
	▪ Monitor savings	Ongoing
Redesign ASEM / revenue cycle management	▪ Launch RFP for external support	August 1, 2018
	▪ Sign contract with provider	September 1, 2018
	▪ Implement revenue cycle management	October 1, 2018
	▪ Review current provider performance and requirement	January 1, 2021
	▪ Launch new provider	June 30, 2021
	▪ Monitor savings and maintain provider relationship	Ongoing

## 12.7 Department of Public Safety (DPS)

### 12.7.1 Current state and future vision for DPS

The Department of Public Safety (DPS) is an agency grouping which was approved by Puerto Rico's Legislature in 2017 (Act 20), and includes seven agencies responsible for **ensuring the safety and security for all residents of the Island (Exhibit 47)**. The grouping includes the following agencies:

#### EXHIBIT 47: LIST OF AGENCIES IN DEPARTMENT OF PUBLIC SAFETY GROUPING

1 Puerto Rico Police Department (PRPD)	5 9-1-1 Services Governing Board
2 Firefighters Corps	6 Institute of Forensic Sciences
3 Emergency Medical Services Corps	7 Special Investigation Unit
4 Emergency Management and Disaster Administration Agency	

The largest agency by spend and personnel is the Police Department (~85% of total DPS spend). As a result, most of measures identified within the grouping apply to the Puerto Rico Police Department (PRPD).

One of the PRPD's main responsibilities is to manage violent crime, defined by the FBI as "murder and nonnegligent manslaughter, forcible rape, robbery, and aggravated assault."<sup>84</sup> Puerto Rico's current level of violent crime is 7,643 crimes per year, based on FBI reporting from 2016. However, **Puerto Rico currently spends more on police per violent crime than most U.S. states**, even after adjusting for differences in PPP; while the PRPD spends \$97,939 per violent crime, the U.S. 50-state median level of spend is only \$88,905.

This elevated spend is partially because **the rate of violent crime in Puerto Rico has been decreasing for the past 10 years without a simultaneous decrease in police expenditures**. While there was an average of 258 incidences of violent crime per 100,000 citizens between 2007 and 2011, the rate of crime decreased to 242 per 100,000 between 2012 and 2016. This decline likely continues into 2018, despite reports of a substantial uptick in crime following Irma and Maria. These contentions have been extrapolated from limited data collected following the Hurricanes. For instance, widespread headlines referring to an 100% increase in murder rates in Puerto Rico after the storm were drawn from only an 11-day window at the start of 2018<sup>85</sup>. Furthermore, academic studies on crime following natural disasters find no empirical evidence of large, sustained elevations in violent crime, outside of some upticks in domestic and spousal abuse<sup>86</sup>.

It is thus the time to take a closer look at the PRPD, not only due to the elevated spend and diminished violent crime rate, but also in conjunction with a 2013 consent decree agreement with the U.S. Department of Justice on reform measures, which compelled the PRPD to conduct a staffing allocation and resources study to assess the proper size of the police force. **The Department is currently undergoing a transformative process to address the requirements under the agreement**. The measures within the New Fiscal Plan, will complement these efforts.

<sup>84</sup> <https://ucr.fbi.gov/crime-in-the-u.s/2010/crime-in-the-u.s.-2010/violent-crime>

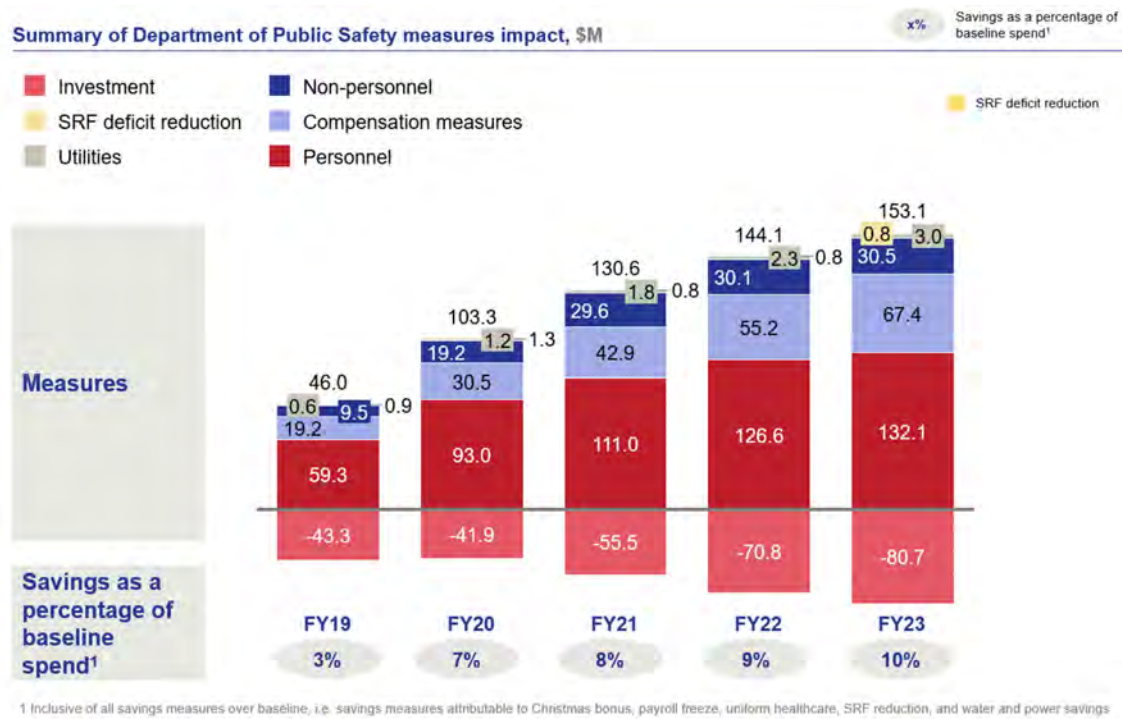
<sup>85</sup> Time, 2017

<sup>86</sup> "Natural Disasters and Social Order", International Journal of Mass Emergencies and Disasters

### 12.7.2 Efficiency measures for DPS

DPS must achieve \$35.1 million in net personnel savings, \$10 million in non-personnel savings and \$0.9 million in SRF deficit reduction savings FY2019. Refer to **Exhibit 48** for annual personnel and non-personnel savings, most of which are based on the Government's proposal and must be achieved through FY2023.

#### EXHIBIT 48: DEPARTMENT OF PUBLIC SAFETY MEASURES SUMMARY OF IMPACT



#### Process improvements

DPS should **reduce administrative tasks and activities** by leveraging modernization, including digitization of incidence reporting, automation of time and attendance, and consolidation of statistical reporting. Furthermore, DPS will streamline vehicle maintenance processes through superior scheduling and procurement protocols, which can reduce the need for vehicle maintenance staff. Process improvements would lead to \$29.5 million in run-rate savings by FY2023.

#### Civilianization of non-core tasks, including outsourcing towing

DPS should replace sworn officers currently performing civilian duties—such as mechanics, radio operators, records and report keepers, area command statistics compilers, and maintenance workers—with **less expensive civilian personnel**. Additionally, DPS can outsource towing services to a third-party vendor to cover approximately ~93% of towing needs. These initiatives would lead to \$5.8 million in run-rate savings by FY2023.

#### Station, unit, and division consolidation and eliminations

DPS should **consolidate police stations, transit units, and specialized units** to reduce the amount of administrative personnel required (e.g., station desk officers, station commanders and directors, stations auxiliary commanders and directors, and vehicle managers). Simultaneously, DPS should **eliminate units and divisions** which perform

duplicative services already provided by other agencies within the Government (e.g., the Divers Unit, the Rescue Squad Division, and Mounted Divisions). These initiatives should jointly lead to \$8.0 million run-rate savings by FY2023.

#### *Overtime efficiencies*

The Government spent approximately ~\$50 million on overtime last year (excluding the outsized overtime needs resulting from Hurricane Maria). This level of overtime is considerably higher than the PPP-adjusted overtime for comparable police forces in U.S. mainland states. For instance, Connecticut, which has a similar population to Puerto Rico and a slightly-higher number of violent crimes (273 per 100,000 inhabitants vs. 224 per 100,000 inhabitants in Puerto Rico), had PPP-adjusted overtime spend of only ~\$28 million in 2017. This gap comes even though Connecticut's total police spend per capita is ~\$140 less than in Puerto Rico<sup>87</sup>.

Through the levers identified in the above measures, in addition to general efficiencies in scheduling and overtime management, DPS can **reduce paid overtime by 60%**. Overtime efficiency efforts should lead to \$30.0 million run-rate savings by FY2023.

#### *Sworn officers back fill and headcount/transitory reductions*

The fiscal plan allows for redeployment of 653 additional officers to the field in response to PRPD's ongoing consent decree adjudication under the U.S. Department of Justice<sup>88</sup>. This measure will lead to \$24.5 million run-rate additional costs by FY2023. Simultaneously, attrition and headcount reductions among non-sworn, regular DPS employees (~162 employees), as well as facilitating the departure of 50% of DPS transitory employees, can create \$58.1 million in annual savings by FY2023.

#### *Salary increase and investment in graduating cadets*

To ensure that DPS continues to **retain police officers**, despite the presence of significantly higher-paying positions within police departments on the U.S. mainland<sup>[1]</sup>, DPS should institute a \$1,500 annual raise for all sworn personnel by FY2019. This measure is expected to lead to \$17.4 million run-rate additional costs by FY2023. In addition, the police department **must train new cadets**. The police department must reopen its academy to graduate new cadets; the last class graduated in 2015. The current plan provided by the police is for the new academy to have an intake in February 2019. To fund the graduating cadets – 400 in FY2021, 450 in FY2022 and 291 in FY2023 – run-rate additional costs of \$38.9 million have been allocated in FY2023 for their salaries as sworn officers.

#### *Uniform healthcare and non-personnel spend*

As detailed earlier in this chapter, these measures to **standardize employee healthcare and decrease non-personnel spend** through procurement optimization (e.g., police fleet vehicles) should lead to \$6.4 million and \$30.4 million in annual savings by FY2023 for uniform healthcare and non-personnel spend, respectively.

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<sup>87</sup> Connecticut Office of the State Comptroller; census data 2014; FBI Crime Justice Information Services

<sup>88</sup> The report is expected to be completed mid-2018

[1] Current average salary for a sworn officer in Puerto Rico is \$34,600, which is ~45% of U.S. median according to the Bureau of Labor Statistics (Police and Detectives)

### 12.7.3 Implementation of reforms

To achieve the New Fiscal Plan's savings projections, reforms within the Department of Public Safety grouping must be implemented according to the schedule described in **Exhibit 49**.

#### EXHIBIT 49: DEPARTMENT OF PUBLIC SAFETY GROUPING KEY IMPLEMENTATION MILESTONES

Areas of focus	Action item	Deadline
Improve processes	Publish plans for improving processes (including automation etc.)	September 1, 2018
	Implement plans for improving processes	December 1, 2018
	Evaluate process improvement strategy	June 30, 2020
	Identify and implement additional process improvement opportunities	Ongoing
Civilianization of non-core tasks, including outsourcing towing	Publish plan of sworn officer positions that can be replaced with civilian-like duties for staff reduction/replacement with civilian counterparts	September 1, 2018
	Identify towing vendors and issue RFPs	September 1, 2018
	Conduct a competitive bid process and identify a towing vendor	September 15, 2018
	Draft contract and negotiate with vendors to establish a service agreement	November 1, 2018
Consolidation/elimination of stations, units and divisions	Evaluate civilianization and outsourcing strategy	June 30, 2020
	Publish plan to consolidate stations, units and divisions	August 31, 2018
	Implement plan	March 1, 2019
	Identify additional consolidation and elimination opportunities	Ongoing
Overtime efficiencies	Publish plan to reduce overtime	August 31, 2018
	Implement plan	December 31, 2018
	Review and evaluate overtime reduction plan	January 1, 2020
Sworn officers back fill and headcount/transitory reductions	Publish plan to fill operational roles for sworn personnel to fill capacity deficiencies	September 1, 2018
	Deploy 644 officers into operational roles	FY 2019
	Monitor deployment progress and evaluate impact to mission	Ongoing
Salary increase	Identify officers eligible for a raise of \$1500 of annual salary	by FY 2019
	Institute \$1500 raise across for 11,929 SAOC agents, Sworn SAOC, PRDP agents, PRDP Sworn officers police officers	by FY 2019
	Monitor retention rates and evaluate need for further raise	Ongoing
Non-personnel spend reduction	Identify addressable non-personnel spend	September 1, 2018
	Reduce non-personnel spend by 1/3 of the total	by FY 2019
	Review procurement spend reduction strategy	January 1, 2021
	Reassess opportunities for procurement efficiencies	January 1, 2023

## 12.8 Department of Corrections and Rehabilitation (DCR)

### 12.8.1 Current state and future vision for DCR

DCR manages the functions and policies of the Puerto Rican correctional system, including penal institutions and rehabilitation facilities, for men, women, and juveniles. The Correctional Health Department provides healthcare to the inmates under the jurisdiction of DCR. Their combined FY2018 budgets are \$441 million, and they include a total of 7,809

employees and 9,320 prisoners based on latest available data, leading to total spend of ~\$47,000 per prisoner. Both agencies are part of the DCR grouping (**Exhibit 50**).

EXHIBIT 50: LIST OF AGENCIES IN FUTURE STATE DEPARTMENT OF CORRECTIONS AND REHABILITATION GROUPING

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1 Department of Corrections and Rehabilitation

2 Correctional Health Department

**DCR's combined number of employees is much higher than the relative number of employees in peer prison systems within mainland U.S. states.** While the reality of an aging prison system dependent on outdated technology necessitates a relatively higher number of employees, the actual number of employees is substantially higher than comparable benchmarks; whereas DCR's current FTE-to-inmate ratio is 0.84, the 50<sup>th</sup> percentile of U.S. states has only 0.41 FTEs per inmate.<sup>89</sup> Additionally, Puerto Rico's prisons are underutilized: while most U.S. state prison systems are near 100% utilization<sup>90</sup>, Puerto Rican prison facilities are only 78% utilized due to declines in the prison population over the past decade that have not translated into reductions in government resources dedicated to prisons.

By **rightsizing Puerto Rico's correctional facilities and FTE footprint** to reflect changes in the prison population and by improving procurement effectiveness across all categories, the Government must achieve five-year cost savings of \$558 million.

*12.8.2 Efficiency measures for DCR*

DCR must achieve \$34.1 million in personnel savings, \$10.1 million in non-personnel savings and \$0.3 million in SRF deficit reduction savings in FY2019. Refer to **Exhibit 51** for annual personnel and non-personnel savings that must be achieved through FY2023.

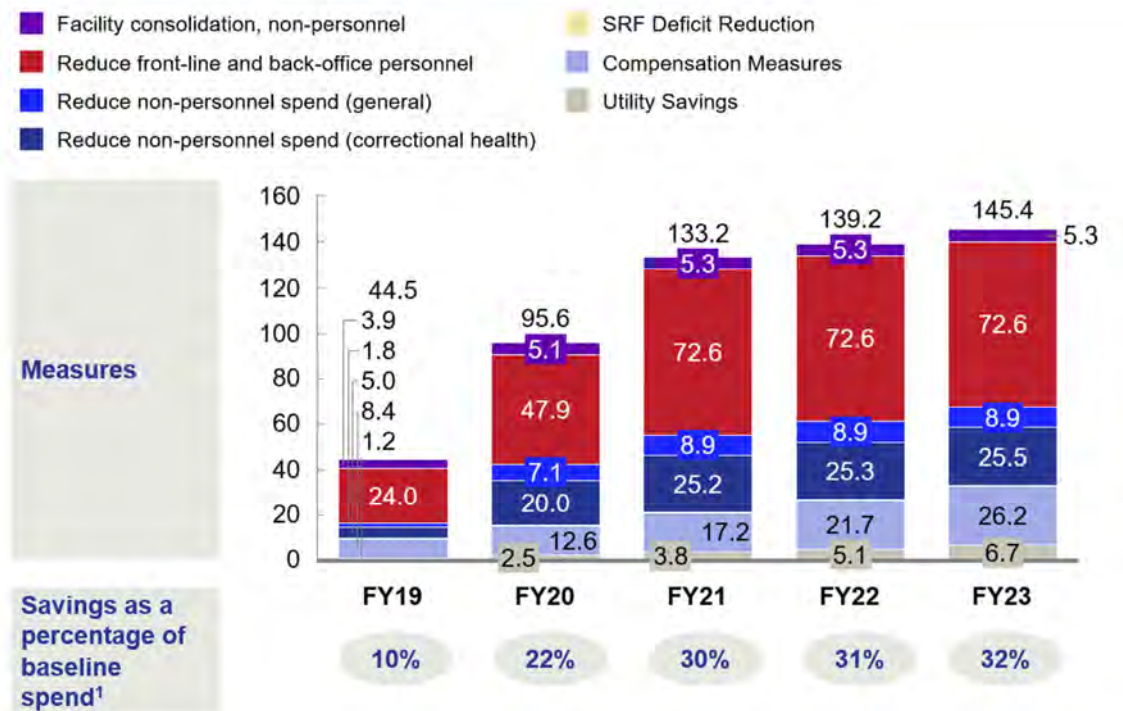
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<sup>89</sup> NASBO, FBI, BJS databases

<sup>90</sup> Census data, 2014; Bureau of Justice Statistics, 2014

EXHIBIT 51: DEPARTMENT OF CORRECTIONS AND REHABILITATION MEASURES SUMMARY OF IMPACT

Summary of Department of Corrections measures impact, \$M



<sup>1</sup> Inclusive of all savings measures over baseline, i.e. savings measures attributable to Christmas bonus, payroll freeze, uniform healthcare, SRF reduction, and utility savings

*Facility consolidations*

To bring the system in line with the requirements of the population and to increase utilization across all prisons, **DCR should close approximately 9 prisons to reach an overall system utilization of 93%**, while still maintaining appropriate separation of different inmate risk profiles and populations, including men, women, and juveniles. These consolidations will provide the opportunity to capture **both personnel and non-personnel savings through reduced operational costs**.

**First, 40% of non-personnel operating expenditures could be captured for each closed facility** by consolidating physical footprint, winding down contracts, and other levers, with the remaining operating expenditures transferred to support population increases in other facilities and account for inability to reduce fixed costs. **Personnel savings could be captured by reducing DCR FTEs per inmate** to reach the U.S. median benchmark of 0.41 FTEs per inmate through attrition and active workforce reductions<sup>91</sup>.

Five prisons are slated for closure in FY2018,<sup>92</sup> and their prisoners have already been relocated to other prisons. Two additional prisons are expected to be closed in FY2019, and two more in FY2020. Implementation costs that are accounted for in savings calculations include

<sup>91</sup> Census data, 2014; Bureau of Justice Statistics, 2014

<sup>92</sup> These are identified as prisons with prison populations of 0, based on latest data from DCR and Rehabilitation; they include: Esc. Ind. Mujeres Vega Alta, Hogar Adaptación Soc. Vega Alta, Inst. Correccional Zarzal, Modular Detention Unit, and Vivienda Alternativa Anexo 246 Ponce

transporting prisoners to other facilities, frictional costs of redundant personnel across prisons and inmates, among other initiatives.

To further enable savings from consolidations and reduced FTEs, DCR may contemplate initiatives to actively reduce prison population as appropriate, such as alternative custody, diversion and/or credits for good behavior/program completion, programs to reduce recidivism like in-prison drug rehabilitation, and increased training and occupational programs.

#### *Non-personnel optimization*

DCR currently spends \$73 million on **procurement**, costs that can be reduced through a variety of means, including leveraging the Federal General Services Administration, utilizing e-auctions, launching competitive Requests for Proposal (RFPs), centralizing purchasing to the greatest extent possible, and outsourcing/contracting responsibilities. Using benchmark savings percentages for major spend areas would result in ~\$9 million potential savings opportunity, excluding correctional healthcare.

For **correctional healthcare**, the Government currently spends ~\$6,000 per inmate based on the terms of the Physician HMO, Inc. contract. By comparison, the 50<sup>th</sup> percentile of U.S. states spend \$3,800 per inmate.<sup>93</sup> Bringing this per-inmate spend in line with the 50<sup>th</sup> percentile of U.S. states would generate annual savings of ~\$25 million by FY2023.<sup>94</sup> The Government can unlock these savings by renegotiating existing contracts, launching competitive RFPs for other correctional healthcare providers that will provide terms more in-line with mainland spending practices, reconsidering level of service due to the currently declining prison population, and strategically evaluating insourcing options.

#### *12.8.3 Implementation of reforms*

To achieve the New Fiscal Plan's savings projections, reforms within the Department of Corrections and Rehabilitation grouping must be implemented according to the schedule described in **Exhibit 52**.

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<sup>93</sup> Source: Pew data 2011, normalized for GDP PPP and inflated to 2017 dollars based on CPI data (2011-2017 compounded inflation rate of 10%)

<sup>94</sup> Pew data, 2011

EXHIBIT 52: DEPARTMENT OF CORRECTIONS AND REHABILITATION GROUPING KEY IMPLEMENTATION MILESTONES

Areas of focus	Action item	Deadline
Consolidate facilities	▪ Publish plans to consolidate prisons	August 1, 2018
	▪ Close 5 prisons	September 1, 2018
	▪ Implement plan to reuse or sale buildings	October 1, 2018
	▪ Close further 2 prisons	February 1, 2018
	▪ Implement plan to reuse or sell additional buildings	March 1, 2018
	▪ Evaluate opportunities for additional closures	Ongoing
Rightsizing personnel	▪ Publish plans to reduce headcount across DCR system	August 1, 2018
	▪ Commence stage one of rightsizing	September 1, 2018
	▪ Implement further agency efficiency measures	July 1, 2019
	▪ Complete agency efficiency measures	June 30, 2021
Optimize procurement spend	▪ Publish plans for consolidation of procurement spend	September 1, 2018
	▪ Initiate RFPs as needed for vendors to improve quality and cost of services	September 15, 2018
	▪ Select vendors and sign contract to address min. 20% of procurement costs	October 1, 2018
	▪ Review procurement strategy	January 1, 2021
	▪ Reassess opportunities for procurement efficiencies	January 1, 2023
Redesign correctional health program	▪ Launch RFP for correctional health services	October 1, 2018
	▪ Appoint vendor for services	December 1, 2018
	▪ Implement new contract	January 1, 2019
	▪ Confirm strategy for any additional savings needed beyond those in contract	July 1, 2020

## 12.9 Hacienda / Office of the CFO (OCFO)

### 12.9.1 Current state and future vision for Hacienda / Office of the CFO

Currently, the financial management functions—as well as basic administrative functions—of the Government are spread across several entities; for instance, the Office of Management and Budget is responsible for administering the Annual Budget of Puerto Rico, the General Services Administration is responsible for procurement processes, and ownership of other fiscal and payroll responsibilities are distributed across another four agencies. This distribution has led to historical problems for the Government, as the number of bank accounts, special revenue funds, and other untracked funding and expenditure streams have proliferated. Indeed, the lack of one office that has authority over all revenues and expenditures—and is also accountable for balancing the budget—has been a **major barrier for the Commonwealth’s ability to regain its fiscal sustainability and publish accurate and timely financial reporting.**

As discussed above, consistent with the Government’s proposal, the Commonwealth shall **consolidate all financial management, HR and procurement activities under the OCFO.** The OCFO will have authority and accountability over the following agencies, which could be consolidated or eliminated (**Exhibit 53**):

EXHIBIT 53: LIST OF AGENCIES IN FUTURE STATE HACIENDA / OCFO GROUPING

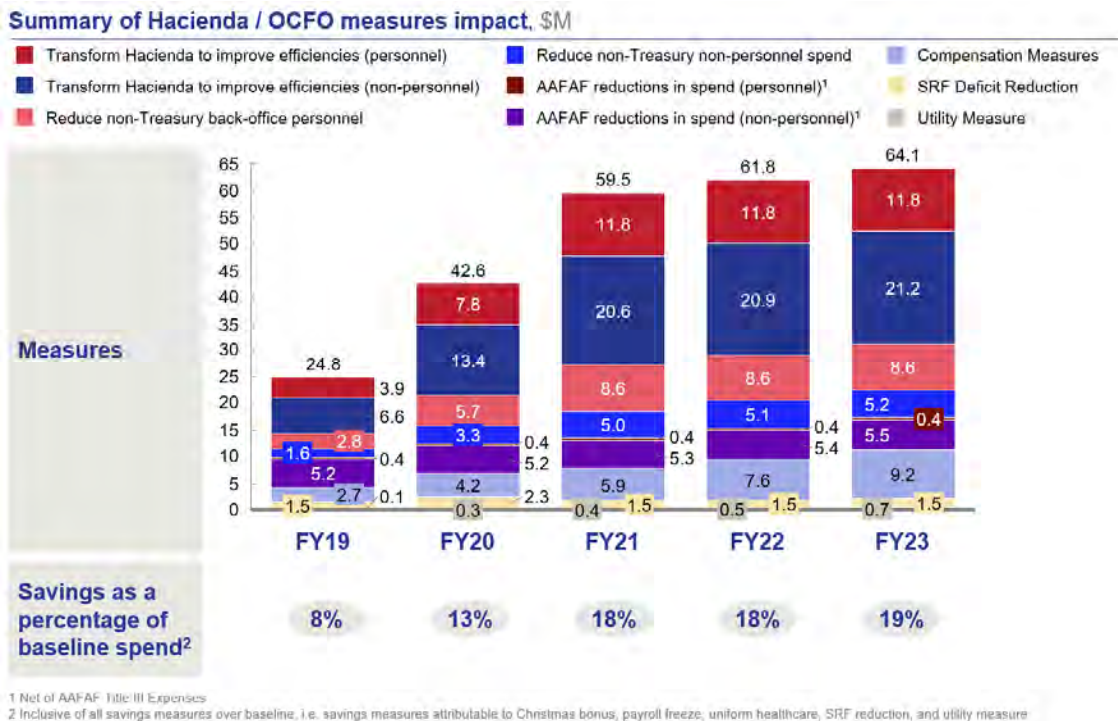
1 Department of Treasury (Hacienda)	4 Treasury (Internal entity)
2 Office of Management and Budget	5 General Services Administration
3 Office of Administration and Transformation of HR	6 Financial Advisory Authority and Tax Agency of Puerto Rico (AAFAF)

Expected roles and responsibilities of the new OCFO / Hacienda are detailed above. Below represents the expected savings resulting from the consolidation of the agencies included in this new organization.

*12.9.2 Efficiency measures for Hacienda / Office of the CFO*

Hacienda / OCFO must achieve \$12.5 million in personnel savings, \$10.8 million in non-personnel savings and \$1.5 million in SRF deficit reduction savings in FY2019. Refer to **Exhibit 54** for annual personnel and non-personnel savings that must be achieved through FY2023.

EXHIBIT 54: HACIENDA/ OFFICE OF THE CFO MEASURES SUMMARY OF IMPACT



*Transform Hacienda to improve efficiencies*

Hacienda itself must attain an overall **15% net reduction in costs (approximately \$33 million), which is 25% gross (approximately \$55 million)** which is in line with the level of cuts seen in other Treasury Department transformations. For instance, a transformation within Her Majesty's Revenue and Customs agency in the UK successfully cut costs by 25% over a five-year period through a series of management initiatives, including reducing IT costs, increasing operational efficiency, reducing the real estate footprint, and

overall process improvement.<sup>95</sup> Many of initiatives can be leveraged by Hacienda, in addition to reforms unique to Puerto Rico, including but not limited to:

- Partnerships with private banks to reduce real estate and personnel footprint (estimated to save approximately ~\$20 million per year)
- Non-personnel spend (e.g., support service consolidation) and procurement optimization (estimated to save approximately ~\$21 million per year)
- Initiatives related to digitization and general process and efficiency improvements

While Hacienda must target gross reductions of 25%, 40% of these reductions (~\$22 million) should be **reinvested in compliance activities**, providing the budget for hiring additional Hacienda employees needed to implement new compliance activities, as well as for technology investment. After subtracting the ~\$22 million to be reinvested in compliance activities, this measure amounts to \$33.0 million in annual net savings by FY2023.

*Reduce non-Treasury back-office and non-personnel*

Overall **back office and non-personnel savings** targets are detailed in *Sections 12.2 and 12.3*, and include levers such as procurement optimization, consolidation of support functions, and similar initiatives. Back office savings must lead to \$8.6 million run-rate savings by FY2023, and non-personnel savings must lead to \$5.2 million in annual savings by FY2023.

*AAFAF reductions in spend*

AAFAF will be subjected to a 7.5% cut (roughly ~50% of the level of cuts prescribed to other government agencies). These cuts must lead to savings of \$5.9 million per year by FY2023.

*12.9.3 Implementation of reforms*

To achieve the New Fiscal Plan's savings projections, reforms within the Hacienda / OCFO grouping must be implemented according to the schedule described in **Exhibit 55**.

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<sup>95</sup> National Audit Office, "Reducing Costs in HM Revenue & Customs," 2011

EXHIBIT 55: HACIENDA / OCFO GROUPING KEY IMPLEMENTATION MILESTONES

Areas of focus	Action item	Deadline
Consolidate agencies	Pass legislation of merging entities	September 1, 2018
	Finalize system mergers between entities	June 30, 2019
	Complete all process and organizational changes	June 30, 2020
Transform Hacienda efficiencies	Identify major contract opportunities and estimate value	October 31, 2018
	Develop strategy for footprint consolidation and digitalization	November 1, 2018
	Start re-negotiations of target contracts	December 1, 2018
	Identify retail banking partners	December 31, 2018
	Roll out trial of consolidating services in bank real estate and start site closures	March 31, 2019
	Finalize plan for footprint reduction informed by pilot	June 30, 2019
	Review of procurement savings achieved and develop strategy for FY20	June 30, 2019
	Launch consolidation in all municipalities and finalize closures	June 30, 2021
	Assess impact of digitalization and footprint consolidation and identify future opportunities	Ongoing
Reduce non-Treasury back-office and non-personnel	Complete capacity analysis for new merged entity	September 1, 2018
	Conduct scan of non-personnel spend and prioritize by major opportunities for savings	September 1, 2018
	Define plan to execute on priority opportunities	November 1, 2018
	Publish plan for new organizational structure with plans for reduction in personnel	November 1, 2018
	Review personnel rightsizing in light of above initiatives	June 30, 2019
	Complete personnel rightsizing to end state	June 30, 2021
AAFAF reductions in spend	Reduce non-personnel spend by 30%	Ongoing
	Identify savings opportunities	October 1, 2018
	Create roadmap to achieve savings	December 31, 2018
	Achieve target savings of \$3m in FY23	June 30, 2023

## 12.10 Department of Economic Development (DDEC)

### 12.10.1 Current state and future vision for the Department of Economic Development

DDEC includes a consortium of agencies critical to **incentivizing and managing the economic recovery of Puerto Rico's private sector**. To promote growth, DDEC is driven by a strategic economic plan to promote high-impact projects, reenergize existing industries, and promote new strategic initiatives. In addition, DDEC manages a variety of programs on the Island intended to promote Puerto Rican entrepreneurship, youth employment, and other critical economic development functions. In the aftermath of Hurricane Irma and Maria, these programs will be crucial for the vitality of the Puerto Rican economy through increasing participation in the job market and attracting new business to the Island.

The agencies to be consolidated are as shown below (**Exhibit 56**).

EXHIBIT 56: LIST OF AGENCIES IN FUTURE STATE DEPARTMENT OF ECONOMIC DEVELOPMENT GROUPING

1 Department of Economic Development and Commerce (DDEC)	6 Commonwealth of Puerto Rico Regional Center Corporation
2 Puerto Rico Industrial Development Company	7 Local Redevelopment Authority for Roosevelt Roads
3 Puerto Rico Trade and Export Company	8 Permits Management Office
4 Office of Industrial Tax Exemption	9 Puerto Rico Tourism Company
5 State Office of Energy Policy	10 Planning Board

The agencies within the grouping are responsible for a variety of efforts to maintain a robust economic marketplace within Puerto Rico, including supervising public policy, creating and retaining jobs, attracting capital investment, and promoting tourism. However, the diffusion of these weighty responsibilities across so many agencies has led to an **inconsistent approach to overall economic development**. For instance, the Government currently lacks a coherent development strategy between the existing incentives code and the initiatives pursued by agencies within DDEC, and until now there has been no single entity solely responsible for incentivizing foreign direct investment in Puerto Rico.

Under the new grouping construct, DDEC should be better able to coordinate its efforts to spur economic development by providing clear goals and metrics for success. In addition, it will drive savings by reducing the back-office operations of the newly-consolidated agencies, pursuing digitization, procurement centralization and other efforts to reduce non-personnel spend, and reducing the number of front-line personnel to better reflect mainland standards for a right-sized economic development operation.

#### *12.10.2 Efficiency measures for DDEC*

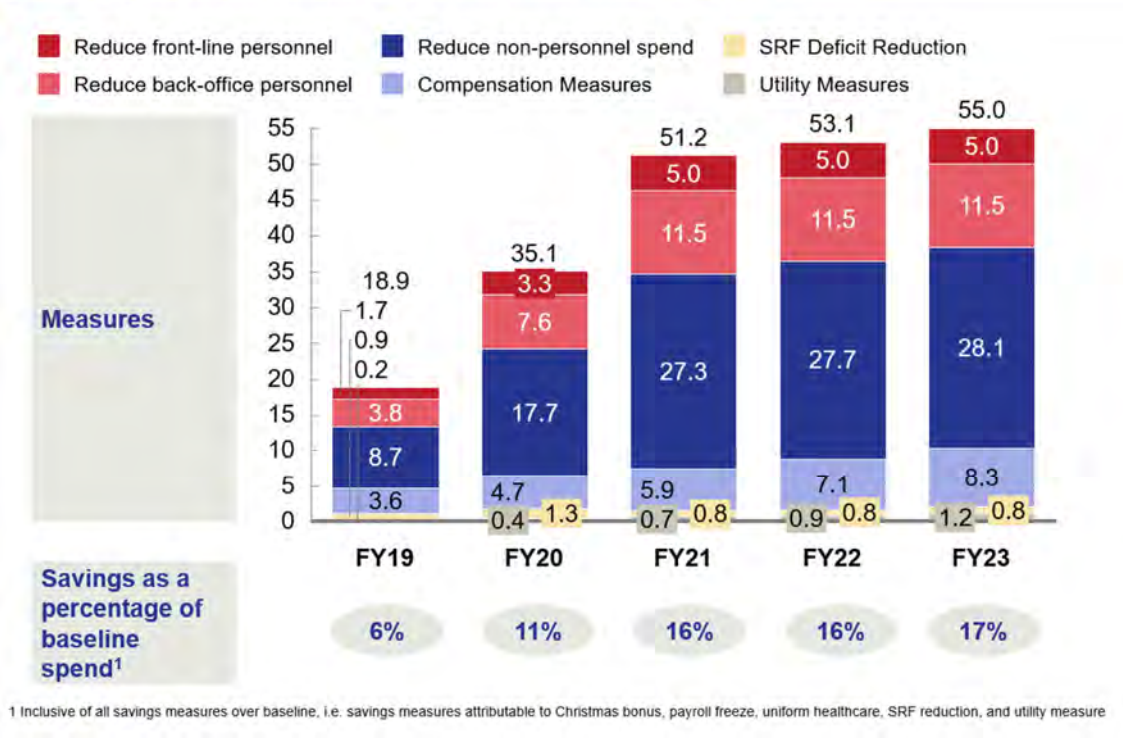
The following stipulations will govern the future state of DDEC:

- The DDEC budget should include **carve outs for Discover Puerto Rico and Invest Puerto Rico**, as these institutions will perform complementary functions to DDEC
- Each entity within DDEC grouping should have **clearly defined responsibilities and governance structures** that limit costs moving forward and prevent overlapping duties among agencies in the grouping (e.g., specific marketing / promotion agency mission should be separate from the corporate development / retention agency)

DDEC must achieve \$9.0 million in personnel savings, \$8.9 million in non-personnel savings and \$0.9 million in SRF deficit reduction savings in FY2019. Refer to **Exhibit 57** for annual personnel and non-personnel savings that must be achieved through FY2023.

EXHIBIT 57: DEPARTMENT OF ECONOMIC DEVELOPMENT MEASURES SUMMARY OF IMPACT

Summary of Department of Economic Development measures impact, \$M



*Right-size the number of front-line employees*

Therefore, DDEC should **reduce front-line personnel** by 20% to ensure a streamlined, efficient organization, leading to \$5.0 million in run-rate savings by FY2023.

*Right-size the number of back-office employees*

A government analysis identified a redundancy in service of back-office personnel across DDEC.<sup>96</sup> DDEC could **consolidate back-office operations** of the newly-merged agencies as detailed in *Sections 12.2 and 12.3*, leading to \$11.5 million run-rate savings by FY2023.

*Optimize non-personnel spend*

DDEC must pursue a variety of initiatives to **reduce non-personnel spend**, primarily centered on procurement optimization and digitization of operations (e.g., digitizing the permit application process), as detailed earlier in Chapter 12. These initiatives must lead to \$28.1 million run-rate savings by FY2023.

*12.10.3 Implementation of reforms*

To achieve the New Fiscal Plan's savings projections, reforms within the Department of Economic Development grouping must be implemented according to the schedule described in **Exhibit 58**.

<sup>96</sup> DDEC analysis, 2018

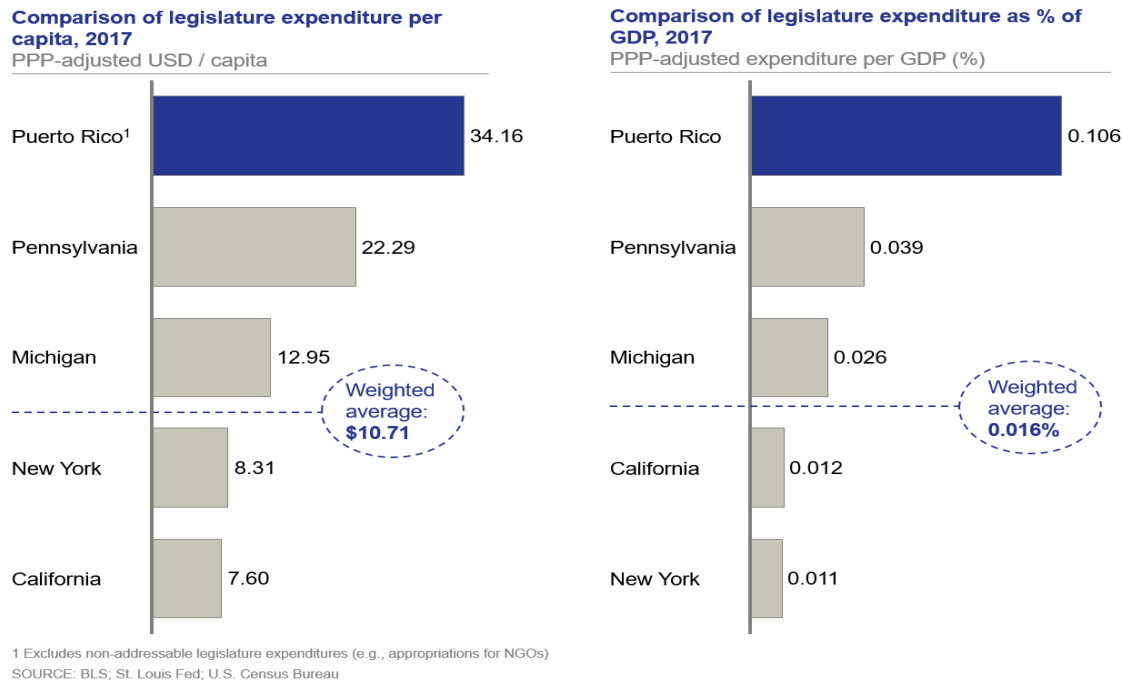
**EXHIBIT 58: DEPARTMENT OF ECONOMIC DEVELOPMENT GROUPING KEY IMPLEMENTATION MILESTONES**

Areas of focus	Action item	Deadline
Consolidate agencies	Pass legislation of merging entities	September 1, 2018
	Finalize system mergers between entities	June 30, 2019
	Complete all process and organizational changes	June 30, 2020
Right-size the number of employees	Complete capacity analysis for new merged entity	September 1, 2018
	Publish plan for new organizational structure with plans for reduction in personnel – both front line and back office	November 1, 2018
	Full implementation of agency efficiency plan	June 30, 2019
Optimize non-personnel spend	Conduct scan of non-personnel spend and prioritize by major opportunities for savings	September 1, 2018
	Define plan to execute on priority opportunities	November 1, 2018
	Reduce non-personnel spend by 30%	Ongoing

## 12.11 Legislative Assembly and the General Court of Justice

The current size of the Puerto Rican Legislative Assembly is significantly larger than comparable legislatures in U.S. mainland states, even when accounting for the demands of full-time legislatures and excluding the money that the Legislature spends on supporting non-profit organizations. Per **Exhibit 59**, whereas Puerto Rico spends \$34.16 per citizen on addressable legislature expenditure, the weighted average expenditure per capita for U.S. mainland legislatures is \$10.71. Similarly, Puerto Rico has outsized spend on a percentage of GDP basis.

**EXHIBIT 59: BENCHMARKING LEGISLATIVE ASSEMBLY AGAINST U.S. FULL-TIME LEGISLATURES**



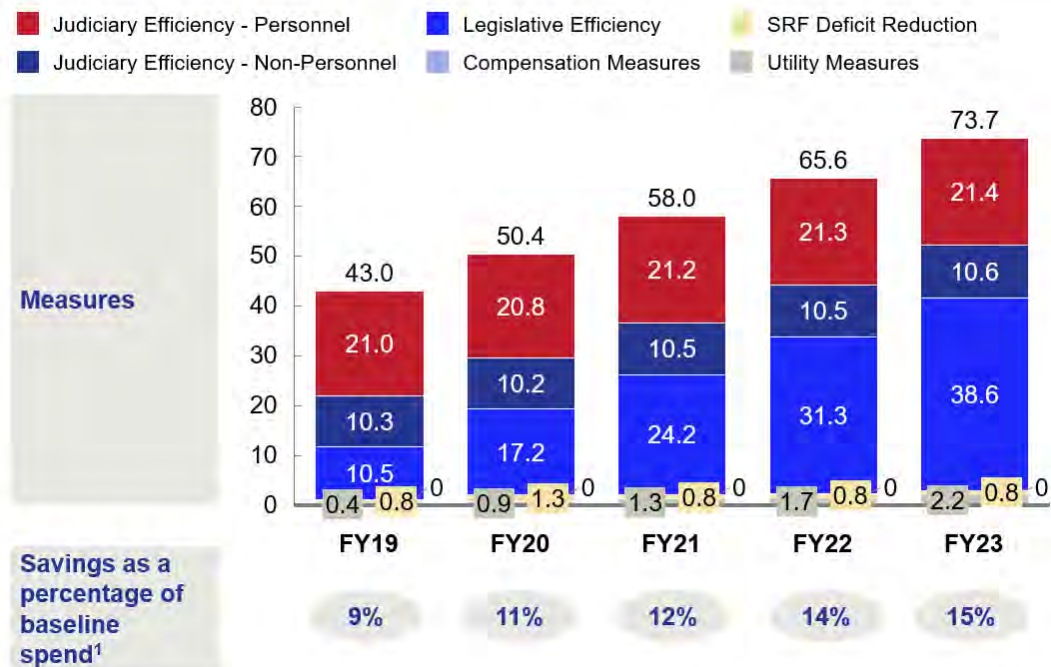
Reductions to the size and funding of the Legislature are necessary to bring it in line with benchmarks and optimize government funds. Hence, the Legislature will experience right-sizing measures proportional to those experienced by all agencies in the Executive Branch.

**The General Court of Justice, although to a lesser extent, is similarly over U.S. mainland cost benchmarks** (by ~35% when compared to the median cost mainland full-time Judiciaries), and will therefore also experience agency efficiency measures equivalent to a 10% reduction in their annual budget.

Courts and Legislature must achieve \$21.0 million in personnel savings, \$21.2 million in non-personnel savings and \$0.8 million in SRF deficit reduction savings in FY2019. Refer to **Exhibit 60** for annual savings that must be achieved through FY2023.

#### EXHIBIT 60: GCJ / LEGISLATIVE ASSEMBLY MEASURES SUMMARY OF IMPACT

##### Summary of Courts and Legislature measures impact, \$M



<sup>1</sup> Inclusive of all savings measures over baseline, i.e. savings measures attributable to Christmas bonus, payroll freeze, uniform healthcare, SRF reduction, and utility measure

## 12.12 Agencies that promote public integrity and transparency

There is wide agreement that to drive a successful fiscal transformation within the Government of Puerto Rico, it will be important to promote public integrity and transparency at every turn. Within the Government, several agencies are dedicated to maintaining oversight and fiscal responsibility; namely, the Office of the Comptroller and the Office of Government Ethics. In line with the priorities of the Governor, the functioning of these agencies is critical to achieving the goals and ensuring the long-term sustainability of the New Fiscal Plan. Accordingly, the budgets for the Office of the Comptroller and the Office of Government Ethics will not be affected by agency-specific right-sizing measures.

## 12.13 All other agencies

The following agency groupings were evaluated using a top-down approach which primarily relied on the levers and initiatives highlighted earlier in Chapter 12. **Exhibit 61** shows the summary of the savings that each grouping must achieve.

EXHIBIT 61: PROPOSED SAVINGS TARGETS FOR OTHER AGENCY GROUPINGS

Savings targets <sup>1</sup> , \$M					
Grouping	FY19	FY20	FY21	FY22	FY23
Agriculture	4.6	7.7	10.9	11.3	11.8
Automobile Accident Compensation Authority	9.3	16.6	20.9	21.8	22.7
Culture	2.5	4.8	7.2	7.6	7.9
Environmental	9.5	17.4	25.0	26.3	27.7
Executive Office	12.4	22.2	32.5	35.0	37.6
Finance Commission	2.2	3.8	4.7	5.0	5.2
Financial Oversight and Management Board	5.3	5.6	5.6	5.6	5.6
Institute of Statistics	0.2	0.3	0.4	0.4	0.5
Justice	5.6	11.5	17.4	18.9	20.3
Labor	10.1	18.3	24.3	26.1	27.9
Land	1.7	3.1	4.2	4.4	4.6
Ombudsman	0.9	1.7	2.5	2.7	2.9
Public Works	20.3	37.4	53.7	56.6	59.9
Social Welfare	18.2	29.6	40.1	50.7	60.5
State	1.4	2.6	3.6	3.8	4.0
State Insurance Fund Corporation	18.1	38.1	59.0	63.8	68.7
Universities (excluding UPR)	0.8	1.2	1.6	1.8	2.0
Utilities Commission	1.8	3.1	3.7	4.0	4.2
Independent Agencies	13.7	21.9	29.2	32.0	35.0
Transparency & Control Entities	1.0	1.0	1.0	1.0	1.0
Closures	0.8	1.1	1.5	1.7	1.8
<b>Total</b>	<b>140.4</b>	<b>248.8</b>	<b>349.2</b>	<b>380.5</b>	<b>411.9</b>

1 Savings include additional personnel savings achievable through compensation measures (payroll freeze, uniform healthcare, Christmas bonus), additional savings attributable to each agency grouping as part of the OCFO's special revenue fund deficit reduction measure (detailed in the OCFO chapter of the New Fiscal Plan), as well as power and water savings

**Exhibit 62** details the implementation schedule for all other agencies within the Government that must be followed to achieve the New Fiscal Plan's savings projections.

EXHIBIT 62: ALL OTHER AGENCIES GROUPINGS KEY IMPLEMENTATION MILESTONES

Areas of focus	Action item	Deadline
Consolidate agencies	Pass legislation of merging entities	September 1, 2018
	Finalize system mergers between entities	June 30, 2019
	Complete all process and organizational changes	June 30, 2020
Rightsizing personnel	Complete capacity analysis for new state entity	September 1, 2018
	Publish plan for new organizational structure with plans for reduction in personnel	November 1, 2018
	Full implementation of agency efficiency plan	June 30, 2019
Optimize non-personnel spend	Conduct scan of non-personnel spend and prioritize by major opportunities for savings	September 1, 2018
	Define plan to execute on priority opportunities	November 1, 2018
	Reduce non-personnel spend by Fiscal Plan targets	Ongoing

## Chapter 13. HEALTHCARE REFORM

### 13.1 Current State of Puerto Rico's Medicaid program

Prior to Maria, 46% of Puerto Ricans received their health coverage through the Commonwealth's state-run insurance program, Mi Salud; this was the highest share of publicly funded health insurance coverage in America, with the next highest state, West Virginia, covering only 29% of its population under public plans.<sup>97</sup> In addition to its large coverage population, Puerto Rico lags mainland states in both health outcomes and access. Puerto Ricans face higher rates of chronic conditions like hypertension (11.3%-points higher than the U.S. mainland), diabetes (4.4%-points higher), and asthma (1.6%-points higher).<sup>98</sup> Only 28% of the 62,000 Mi Salud members with diabetes and 17% of the 132,000 Mi Salud members with hypertension are in the respective disease management programs. Puerto Rico also has higher premature birth and infant mortality rates,<sup>99</sup> and higher rates of adults reporting fair or poor health.<sup>100</sup> At the same time, 72 of Puerto Rico's 78 municipalities are deemed "medically underserved areas",<sup>101</sup> with 500 doctors leaving per year (pre-Maria). Puerto Rico has half the rate of specialists as compared to the mainland in critical fields (e.g., emergency physicians, neurosurgeons).<sup>102</sup>

Mi Salud covers individuals through three primary funding sources: Federally matched Medicaid, the Children's Health Insurance Program (CHIP), and the Commonwealth's self-funded insurance program for low-income adults who do not qualify for federally-matched Medicaid. An additional ~7.5% of the Puerto Rican population receives some benefits from Mi Salud as part of the Platino program, which supports Medicare recipients who also qualify for Medicaid (also known as "dual-eligible"). Annually, these programs collectively cost \$2.80 billion (as of FY2018), with the Commonwealth responsible for the vast majority of costs due to caps on federal matching (see *Section 5.1.2* for more information on Medicaid federal funds). Puerto Rico faces real and growing challenges with rising healthcare costs, with premiums growing significantly faster than inflation. Even with some cost containment measures in place, per-member per-month (PMPM) disbursements rose 6.3% from FY2017 to FY2018. And based on national healthcare cost inflation trends plus increased post-hurricane need, Mi Salud PMPMs are projected to rise by nearly 24% over the next 5 years in the absence of additional measures.

The Bipartisan Budget Act of 2018 (BBA 2018) provides the Commonwealth temporary relief from raising healthcare costs by expanding the amount of federal reimbursement over the next 18 months. Starting in September 2019, however, the Commonwealth will hit a "Medicaid cliff" whereby it will be responsible for multi-billion-dollar annual healthcare expenditures unseen since before the passage of the Affordable Care Act provided additional federal funding in 2011. It is crucial, therefore, that ASES take advantage of the additional runway provided by

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<sup>97</sup> Kaiser Family Foundation, "Medicaid State Fact Sheets: Percent of People Covered by Medicaid/CHIP, 2015"

<sup>98</sup> CDC (Centers for Disease Control and Prevention), "BRFSS Prevalence and Trends Data," 2015-2016. Behavioral Risk Factor Surveillance System

<sup>99</sup> Puerto Rico infant mortality rate is 6.4 per 1000 (2016) vs. U.S. 5.8 per 1000; premature birth rate is 11.8% vs. 9.6% in U.S. "Puerto Rico," World Factbook (Washington, DC: CIA)

<sup>100</sup> 35.4% of Puerto Ricans report fair or poor health, versus 17.9% U.S. average, and 19.3% in Florida and 22.0% in Mississippi (two most comparable states). Table 3, Krista Perreira et al. Urban Institute. Jan 2017. "Environmental Scan of Puerto Rico's Health Care Infrastructure"

<sup>101</sup> Areas with a shortage of personal health services, e.g., areas or populations that have too few primary care providers, high infant mortality, high poverty, and/or high older adult population

<sup>102</sup> U.S. Department of Health and Human Services, Office of the Assistant Secretary for Planning and Evaluation, "ASPE Issue Brief: Evidence Indicates a Range of Challenges for Puerto Rico Health Care System" (Jan 12, 2017)

the BBA funding to put in place reforms that reduce long-term health expenditure growth rates.

### 13.2 Future vision for healthcare reform

The future vision for the Puerto Rican healthcare system is to cultivate a healthier population overall by providing high-quality services to all citizens in need. To do so, the Government has proposed targeting the following:

1. **Decrease the annual per-member cost growth rate to the median level of Medicaid growth rate** by implementing value-based healthcare reforms, such as new payment models to incentivize care integration among providers
2. **Shift care from higher-cost to lower-cost channels;** for example, reducing the number of emergency room visits and encouraging and enabling the role of primary care physicians in providing preventative care
3. **Drive better health outcomes for the population,** indicated especially by reduced rates of chronic conditions among adults
4. **Coordinate healthcare initiatives in the community** to promote efficiency of services and a community-wide focus on health

### 13.3 Key initiatives for healthcare reform

Addressing Puerto Rico's healthcare challenges while also reducing costs will require a portfolio of targeted actions in the short term (e.g., reducing waste and abuse) and in the long term (e.g., structural reforms to the healthcare model to improve quality relative to cost).

In early FY2018, ASES began efforts to reduce healthcare costs, including implementation of preliminary enrollment verification efforts with DCR and private insurers; standardization of fee schedules for providers; and prescription drug cost controls such as increased pharmacy discounts on branded drugs, mandatory dispensing of generic drugs, and changes to prescription coverage guidelines.

Beginning in FY2020, the Government must implement a new healthcare model building off FY2019 changes, through changes to how the Island's managed care organizations (MCOs), are contracted and incentivized as the third-party administrators of Mi Salud. The new model's savings must reach a run-rate annual savings of ~\$826.3 million by FY2023 (off the FY2022 baseline of approximately \$3.4 billion), a measure run-rate which is then projected to increase as the baseline expenditures increase.

After FY2023, baseline expenditures increase by an age-mix adjusted PMPM inflation is expected to increase slightly from 4.90% in FY2024 to 5.10% in FY2038, then to fall to 4.85% in FY2058.

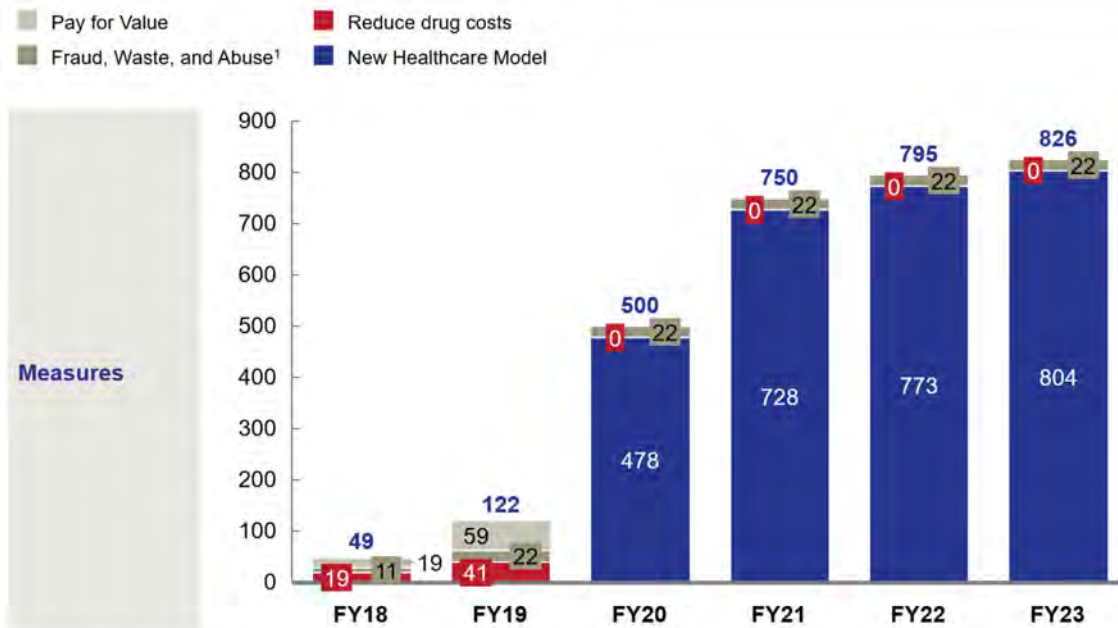
The Government has chosen to begin implementation of the single-region MCO construct a year ahead of schedule (with the new structure expected to commence November 2019). By FY2020, the proposed MCO contracts are expected to achieve \$478 million in savings off the FY2020 baseline through a combination of reforms, including new payment models for reimbursing MCOs for treatment of high-cost, high-need populations. This new model will need to be closely monitored in its initial year of implementation to ensure the additional risk now borne by the Commonwealth materializes projected savings. To achieve future measure targets, which ramp to an annual run-rate savings of \$826.3 million off the FY2023 baseline

expenditure, the Commonwealth will further need to enable and implement additional value-based reforms and other cost containment strategies that help achieve significant annual growth rate reductions in the negotiated PMPMs dispersed to MCOs. FOMB expects ASEs to collaborate closely in designing and implementing these reforms to ensure the Island is on a sustainable path to achieve these saving targets. After FY2024, the New Fiscal Plan assumes the impact of reforms will continue to grow at the same rate as overall per capita (PMPM) healthcare inflation as projected in the baseline scenario.

**Exhibit 63** provides an overview of the core savings measures.

#### EXHIBIT 63: MI SALUD REFORM SUMMARY OF IMPACT

##### Summary of Healthcare (Medicaid) reform impact, \$M



1 Includes MFCU and MMIS

2 Includes only premium-related expenditures for Mi Salud and Platino costs

#### 13.3.1 Pursue value based reforms to improve quality relative to cost of care

Pursuing value-based improvement initiatives with demonstrated success can help reduce Mi Salud's per-member per-month (PMPM) rates. Similar value-based programs have been piloted in other states, and typically save between 2-10% of costs. In Puerto Rico, value-based reforms may result in lower-than-average savings due to the breadth of other simultaneous savings measures being implemented for Mi Salud, and unique post-Hurricane challenges such as a potential increase in behavioral health needs. Value-based reforms will be combined with a portfolio of other initiatives in the "new healthcare model" to achieve savings targets. This measure includes:

**Improved coordination of care.** New approaches that emphasize care coordination and align incentives between patients, providers, and payors can produce improvements in health outcomes while lowering costs. Given the preponderance of chronic conditions and potential rising behavioral and mental health needs in the wake of Hurricane Maria,<sup>103</sup> better access and

<sup>103</sup> Thomas Huelskoetter, Center for American Progress, "Hurricane Katrina's Health Care Legacy" (August 15, 2015)

coordination of mental health services will become increasingly important. Care coordination models like patient centered medical homes – which empower patients to work closely with a primary care provider to manage treatment plans across multiple care providers – have been quite effective at improving outcomes for members with chronic conditions.<sup>104</sup> ASES can serve as a coordination point for care organizations throughout the community, ranging from managed care organizations to education and faith-based community organizations. The new RFP issued by ASES is focused on developing such managed care programs for high cost, high need populations.

**Reduced Emergency Room (ER) visits.** Prior to Hurricane Maria and the reforms, Puerto Ricans utilized the ER three times as often as peers on the U.S. mainland,<sup>105</sup> with estimates as high as 90% of ER visits occurring for non-emergency care that could be treated in lower cost settings. Successfully shifting unnecessary ER visits to lower-cost settings, such as primary care offices or urgent care, could save roughly \$70-75 million annually, or 3% of total Mi Salud costs. Mi Salud could reduce ER utilization through several means, including patient education, increased ER co-pays, or changes to reimbursement policies.<sup>106</sup>

**Reduce inpatient length of stay.** Puerto Rico's inpatient length of stay was 1.5 times the U.S. average in 2014.<sup>107</sup> MCOs can incentivize reduced hospital readmissions and length of stay through improved discharge planning and increased staffing to manage weekend discharges. Some MCOs have already implemented such reforms in Puerto Rico.

**Adjusting MCO payment models.** ASES is already considering many changes to MCO – provider payment models to promote greater accountability and better align care delivery to outcomes amongst providers. Best practice value-based payment models from other managed care settings include direct pay-for-performance quality bonuses, providing fixed payments for a 'bundle' of services required to treat a specific condition, and providing special incentives to care for members with high-cost needs, such as behavioral health.

### *13.3.2 Reduce pharmacy spend*

Prescription drug coverage is the largest category of spend in Mi Salud, contributing 26% of the total cost in treating the average patient. Nearly half of this spend comes from specialty drugs. Even after ASES-negotiated some prescription drug cost reduction measures,<sup>108</sup> pharmacy costs grew 14% annually from FY2016 to FY2018 in Puerto Rico,<sup>109</sup> compared to 6% per year in U.S. Medicaid programs.<sup>110</sup>

Puerto Rico faces structurally higher prices than the mainland because, unlike U.S. states, it cannot participate in the federal Medicaid Drug Rebate Program (MDRP), and may only seek voluntary or supplemental rebates. That said, ASES can lower the cost of prescription drug

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<sup>104</sup> Patient-Centered Primary Care Collaborative, "Benefits of Implementing the Primary Care Medical Home A Review of Cost & Quality Results, 2012" (Sept 2012)

<sup>105</sup> JEL Consulting analysis (Dec 30, 2106) of ASES data and Puerto Rico Community Survey, Public Use Microdata, 2014. Estimates exclude Platino beneficiaries

<sup>106</sup> See, e.g., Schwartz et al. Copayment levels and their influence on patient behavior in the emergency room utilization in an HMO population. *Journal of Managed Care Medicine*. 2012; Wallace et al. How effective are copayments in reducing expenditures for low-income adult Medicaid beneficiaries? experience from the Oregon health plan. *Health Services Research* 2008; Lesley et al. Reducing frequent visits to the emergency department: a systematic review of interventions. *PLOS*. 2015

<sup>107</sup> As of 2014. JEL Consulting analysis (Dec 30, 2106) of ASES data and Puerto Rico Community Survey, Public Use Microdata, 2014. Estimates exclude Platino beneficiaries

<sup>108</sup> FY2018 Milliman Actuarial Certification

<sup>109</sup> Ibid

<sup>110</sup> Express Scripts 2016 Drug Trend Report

coverage by replacing higher cost drugs with cheaper, equally effective alternatives, driving increased use of generics and imposing utilization controls. These initiatives resulted in negotiated savings of \$4.31 PMPM in Mi Salud's FY2018 contracts. However, to sustain these savings, MCOs must engage in ongoing monitoring and enforcement of policy changes to further refine drug coverage lists and utilization management policies due to changing prescription patterns.

### *13.3.3 Reduce fraud, waste, and abuse (FWA)*

The U.S. Government Accountability Office found evidence that MCOs have not consistently reported improper payments to providers billing to the system. Further, it found that many MCOs face conflicts of interest in finding and eliminating fraud.<sup>111</sup> Typical waste, fraud, and abuse reduction programs in other state Medicaid programs and health insurers have been able to achieve 1-3% cost savings. These savings have been reached through: pre-payment review (e.g., reviewing claims before payment to identify outliers/issues); auditing and enforcement units to investigate suspicious behavior; advanced analytics capabilities to review many actions to identify inefficient or fraudulent activities in post-payment review, such as identification of "impossibility" coding (e.g., billing for over 24 hours of service in one day), or frequently repeated or high value procedures; and long term policy or organizational transformation.

To combat FWA:

- The Department of Justice will fully operationalize a Medicaid Fraud Control Unit (MFCU)—which it has already launched—to identify and prosecute fraudulent charges
- Office of the Medicaid to establish a functional Medicaid Management Information System (MMIS) to track utilization, claims, and provide the data inputs for advanced analytics assessments to identify inappropriate spending; and
- Use data to obtain reimbursement for improper payments and to identify and eliminate the systematic causes that enabled the problematic activities in the first place.

Puerto Rico is in the process of establishing an MMIS and an MFCU. Successful operationalization of the MMIS will enable Office of the Medicaid to receive \$1.2 billion of the BBA 2018 allocated funding, contingent upon establishment of methods to lower FWA and collect/report reliable information to the Transformed Medicaid Statistical Information System (T-MSIS).<sup>112</sup>

### *13.3.4 Enrollment verification*

In addition to overpayment for eligible beneficiaries, ASES faces a challenge in ensuring it is serving the proper beneficiaries—and preventing those who are ineligible from receiving benefits. Over-enrollment typically occurs when the system fails to catch residents who have private insurance, are in the corrections system, have moved to other states, or are deceased. Data system limitations (e.g., limited data sharing with other systems; manual dis-enrollment after eligibility expiration) mean that it often takes years to dis-enroll ineligible members, and many are never removed. Over enrollment could be identified through coordination of benefits, interagency data sharing, state-specific MOUs, and the national Public Assistance Reporting Information System (PARIS) and T-MSIS Medicaid interstate match.

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<sup>111</sup> GAO "Medicaid and CHIP Increased Funding in U.S. Territories Merits Improved Program Integrity Efforts," April 2016

<sup>112</sup> MACPAC, "Medicaid and CHIP in Puerto Rico," report, February 2018

Pre-Maria, Mi Salud had an estimated 5% over-enrollment rate, translating to Mi Salud improperly paying for roughly 62,000 beneficiaries.<sup>113</sup> Maria is likely to augment these challenges. Due to the hurricane, 17% of Puerto Rico's FY2018 population is expected to emigrate by FY2023, and it is estimated that a roughly proportionate number of Mi Salud members will also leave the Island. Given the limited data capabilities at present, without active efforts to dis-enroll those who leave and do not return, it is expected that ASES will continue to pay for these departing beneficiaries for a full year after they leave.

### *13.3.5 Implement a uniform fee schedule for providers*

One way ASES has been able to put controls on spend growth is by working with MCOs to implement a new fee schedule for providers. The updated schedule, which went into effect on July 1, 2017, provided 70% of the Medicare reimbursement rate for each category of services, a sharp reduction for some specialty services on the Island (laboratory and radiology in particular) as it reduced the PMPM by an estimated \$3.52 in FY2018.<sup>114</sup> During the period of BBA funding, this fee schedule reduction was relaxed in response to a sharp increase in emigration of specialty providers that was hindering delivery of necessary care.

### *13.3.6 Reduce administrative MCO costs through a single region model*

ASES can reduce MCO administrative costs by switching from the current system of nine regions, each with a single MCO provider, to a geographically unconstrained competitive system with multiple MCOs serving the entire Island. This new single region MCO model should produce increased economies of scale for administrative operations and will lower costs through greater competition and incentives to enforce efforts to lower the cost of care.

ASES has already been moving the MCOs towards improved Medical Loss Ratios (MLRs), constraining the share of their PMPM costs not used for medical services. In the FY2016 contract, 10% of the PMPM went to administrative costs and profits; in the FY2018 negotiated rates, administrative costs and profits fell to 8.6%.<sup>115</sup> In FY2019, ASES plans to improve this MLR to 92% (with an 8% cap on administration and profits).<sup>116</sup>

### *13.3.7 Stop-gap levers to ensure achievement of savings targets*

As an extreme measure in cases where target run-rate savings are unachievable with the above measures, the following additional measures could be implemented to hit expenditure reduction targets.

#### *Require cost-sharing for the Medicaid and Commonwealth populations*

ASES could reduce healthcare spending by imposing cost sharing on specific services to disincentivize high-cost, low-impact behavior, such as visiting an ER for non-emergency services or using certain non-preferred drugs. Co-pays have been shown to reduce use of affected services, and therefore should not apply to preventive care or other areas that reduce net health system costs, such as family planning services. Any required co-pay shall be determined on a service-by-service basis to selectively disincentivize high-cost, low-impact activities; further, co-pays will be implemented progressively, scaled to member income while exempting those without income and CHIP members.

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<sup>113</sup> Ballori Group estimate

<sup>114</sup> FY2018 Milliman Actuarial Certification

<sup>115</sup> FY2016 rate analysis; FY2018 Milliman Actuarial Certification

<sup>116</sup> Communication with ASES, Nov 21, 2017

*Reduce coverage for select optional benefits*

Medicaid requires all states to cover certain services, such as hospital stays, physician visits, preventive health services, family planning, and pregnancy-related care. Other benefits are considered optional, including: prescription drugs; physical, occupational, and speech therapy; dental; podiatry; optometry and glasses; prosthetics; chiropractor services; private duty nursing; hospice; and respiratory care services. Some of these optional benefits are provided by every state (such as prescription drug coverage), while others are covered by fewer than half of states. 4.1% of total Mi Salud payments<sup>117</sup> are related to the following categories of benefits coverage that at least one other state or territory does not cover (**Exhibit 64**):<sup>118</sup>

EXHIBIT 64: OPTIONAL BENEFITS PROVIDED BY PUERTO RICO BUT NOT OTHER STATES/TERRITORIES

Optional benefit type	FY18 PMPM, \$	FY18 projected cost, \$M	States/territories not covering, %
Dental	\$4.38	65.5	7%
DME and supplies, prosthetics	\$1.53	22.9	4%
Private duty nursing/home health	\$0.99	14.8	59%
Professional – PT	\$0.67	10.0	30%
Professional – Vision, hearing, and speech exams	\$0.45	6.7	29%
Benefits glasses/contacts	\$0.14	2.0	18%
Outpatient facility – PT/OT/ST	\$0.04	0.6	36%
<i>Less CHIP portion of benefits<sup>1</sup></i>	<i>\$(0.59)</i>	<i>(10.9)</i>	
<b>Total</b>	<b>\$7.61</b>	<b>112</b>	

<sup>1</sup> CHIP beneficiaries excluded from any potential benefit reduction

As a result, another second stop-gap measure could be to reduce Mi Salud coverage for select optional benefits, either by eliminating some optional benefits, imposing various levels of cost-sharing for remaining benefits, or restricting access. Optional benefit coverage reductions would affect Medicaid and Commonwealth Mi Salud members, but not CHIP members.

### 13.4 Implementation plan and enforcement of healthcare reform

Healthcare reform shall consist of specific measures (pay for value, reduction of drug costs, modification of benefits package, and FWA efforts) in FY2019 during the development of the

<sup>117</sup> When adding back in the \$0.59 PMPM attributable to CHIP coverage that would not be subject to reductions or cost sharing

<sup>118</sup> Kaiser Family Foundation Medicaid Benefits Data Collection, Oct 1, 2012 data (latest available as of Nov 2017). 2 states do not cover prosthetics, while every state covers durable medical equipment and supplies. 33 states do not cover private duty nursing, while every state covers home health services. 20 states do not cover occupational therapy; data was not available on outpatient PT/OT/ST specifically. Puerto Rico data from FY2018 Milliman Actuarial Certification

new healthcare model. The new healthcare model is set to launch on November 1, 2018 **(Exhibit 65)**.

EXHIBIT 65: HEALTHCARE REFORM KEY IMPLEMENTATION MILESTONES

Areas of focus	Action item	Deadline
Overall New Healthcare Model	• Release RFP, publish data-book, hold conferences, and develop proposals for FY2019 MCO contract	December 31, 2017
	• Receive proposals, negotiate rates, award and signed FY2019 MCO contract	June 30, 2018
	• Receive adjudication of FY2019 MCO contract from CMS	October 31, 2018
	• Implement FY2019 MCO contract	November 1, 2018
	• Build out analytics and quality assessment tools	December 31, 2018
	• Conduct first quarterly audit and review of FY2019 MCO contract	March 1, 2019
	• Publish first HEDIS report	March 1, 2019
	• Complete negotiation of rates and finalize amendments to the MCO contract for FY2020	August 15, 2019
	• Conduct second quarterly audit and review of FY2019 MCO contract	May 1, 2019
	• Receive approval of negotiated premiums and amendments to MCO contract for FY2020	Oct 15, 2019
	• Achieve \$500 in savings from new island-wide healthcare model	July 1, 2020
	• Achieve \$750 in savings from new island-wide healthcare model	July 1, 2021
	• Achieve \$795 in savings from new island-wide healthcare model	July 1, 2022
	• Achieve \$821 in savings from new island-wide healthcare model	July 1, 2023
Other Healthcare Cost Savings Initiatives	• Establish a functional Medicaid Management Information System (MMIS) to track utilization, claims, and provide the data inputs for advanced analytics assessments to identify inappropriate spending, while also leveraging the national Public Assistance Reporting Information System (PARIS)	January 1, 2018
	• Pass legislation to establish a Medicaid Fraud Control Unit (MFCU) under PR Department of Justice to identify and prosecute fraudulent charges	June 30, 2018
	• Receive certification of MFCU from HHS Secretary	September 30, 2018
	• Fully operationalize MFCU	December 31, 2018

## Chapter 14. TAX COMPLIANCE AND FEES ENHANCEMENT

### 14.1 Current state and future vision for tax environment

Puerto Rico's current tax system suffers from its structural complexity, instability, internal inconsistency, inefficient administration and inadequate enforcement. This has fueled a culture of tax evasion, promoted by a lack of adequate enforcement personnel, technology and process. Top marginal tax rates are high relative to U.S. federal and state taxes (e.g., 39% for corporations, and 11.5% for sales and use). Much of the Government's revenue is also overly concentrated in collections from a handful of multi-national corporations. To compensate for this unevenness, the Government has issued an assortment of credits, deductions, and incentives that add to the system's complexity and further erode the tax base. Limited audit and enforcement in recent years has also resulted in a "lack of fear" amongst tax filers, who assess that the likelihood of punishment is low and the ability to negotiate consensual settlement agreements if caught are high.

**Due to its compliance and collections issues, the Commonwealth has not been able to drive as many revenues from taxes as it should each year.**

In response to these challenges, the government reports it has already started implementing compliance-related changes within Hacienda. It is driving improvements in its culture and organization to boost enforcement capabilities, streamlining the process of filing taxes and

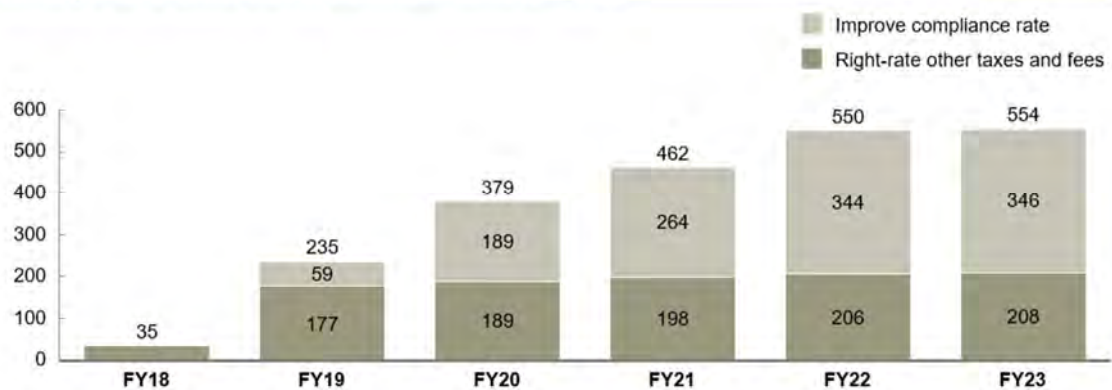
reducing complexity in the system to lighten the burden of compliance on taxpayers. These efforts have already resulted in some success: in 2012, SUT compliance stood at 56%, and by 2016 had improved by 12 percentage points, to 68% compliance.<sup>119</sup> Moving forward, Commonwealth-commissioned tax reform report models estimate that Puerto Rico could reach 75% sales tax compliance.<sup>120</sup>

## 14.2 Administrative tax initiatives to increase revenue collections

By driving administrative reform, the Commonwealth must increase revenues by \$2,216 million over six years, as shown below (**Exhibit 66**). To capture impact, measures must be implemented in full by FY2019.

### EXHIBIT 66: REVENUE MEASURES SUMMARY OF IMPACT

Summary of tax compliance and fees enhancement measures impact, \$M



### 14.2.1 Improve compliance rate

Given the progress to date in improving compliance rates and the ongoing gap to reach mainland performance, **the Government must target a 5% net uplift in annual revenues due to enhanced compliance by FY2022** across the major tax lines (personal income tax, corporate income tax, and SUT) – inclusive of implementation costs. Such an improvement would also be in line with improvements seen in other tax transformations.<sup>121</sup>

Recent compliance efforts in the Commonwealth have largely focused on collections outreach activities, obtaining one-time back taxes owed through a collections call center, flexible payment plans, and a large corporate taxpayer-focused team (with a longer-term goal of establishing a permanent separate unit). In the future, emphasis should shift towards **initiatives that promote a culture of compliance** to boost voluntary payment. The goal

<sup>119</sup> Departamento de Hacienda, November 2016

<sup>120</sup> The report did not address how long it would take to reach this end state. "Commonwealth of Puerto Rico Tax Reform Assessment Project, Unified Tax Code of Puerto Rico: Tax Policy Implementation Options General Explanation of Principal Options" KPMG (October 31, 2014)

<sup>121</sup> Analogous case studies include Panama, Jamaica, and Spain, which saw 1.0 to 2.5 percentage point increases in tax ratio relative to GDP through their comprehensive tax overhauls. Puerto Rico achieving a 5% uplift from compliance, along with the other measures on corporate tax reform and increased fees, would produce a 2.25 percentage point increase in tax ratio relative to GDP, in line with these case studies

should be to reduce the cost of compliance while simultaneously raising the cost of non-compliance, through a combination of an increased likelihood of being caught while not paying taxes owed and more effective and enforceable penalties.<sup>122</sup>

- **Use new systems and processes to identify and remediate non-payment.** Hacienda will create a “premium return system” for individual and corporate taxpayers that enables taxpayers to claim certain deductions and exemptions only if their return is prepared by a certified public accountant following agreed upon procedures; the CPA’s review and certification of the return and supporting documentation as compliant with Puerto Rico’s tax laws would functionally serve as a “pre-audit,” reducing the likelihood of tax evasion and the need for a fuller review by Hacienda.
- **Create a new culture internally and externally** that shifts from the agency existing to serve the public (“*Hacienda para servirle*”) towards emphasis on Hacienda making sure everyone pays their taxes, but with as little friction as possible for the taxpayer and the agency.
- **Reduce the complexity of the tax system and process of filing taxes** to make it easier for individuals and businesses to pay their taxes correctly. Hacienda reports it plans to introduce pre-filled tax returns and fully digitize the tax filing system onto the Internal Revenue Unified System (SURI) platform that will enable easier filing, communication, and levying of penalties for late payment or non-payment. It must also ease the process of paying for licenses, stamps, and fees by shifting from a system of 64 agency payment centers to instead partner with retail banks, enabling taxpayers to pay their fees at any of 200 private sector locations in various communities (and within four years, 1,000 locations).
- **Institute advanced analytics and broad-reach, low-touch correspondence audits.** Small and medium taxpayers account for a significant share of the unpaid and underpaid taxes, but only a tiny fraction of these taxpayers receive full-scale audits due to the significant time and cost investment needed. While a traditional IRS audit costs an average of \$2,278 per case, automated notices or letters can be executed for \$52 to \$274 per case.<sup>123</sup> Hacienda had begun a correspondence audit program prior to Hurricanes Irma and Maria, receiving such a strong response to the first batch of 1,000 letters that it overwhelmed the call center. This program helped contribute to \$7.1 million of collections outreach revenues in the first 2 months of FY2018 (against a \$1.4 million target),<sup>124</sup> with half of those responding to the letters agreeing to pay the proposed penalty amount.<sup>125</sup> Fully implementing data-driven tiered audits will enable Puerto Rico to reach a significantly larger share of nonpayers.
- **Collecting SUT on Internet sales.** Nationally, the percent of taxpayers voluntarily reporting and paying sales and use taxes on their income tax forms ranges from 0.2% to 10.2%,<sup>126</sup> while nearly 80% of Americans shop online.<sup>127</sup> The mainland already permits states to collect SUT on online sales; through legislation combining click-through nexus, affiliate nexus, and economic nexus, as well as voluntary agreements with major online retailers, the Government should be able to capture SUT on a much larger share of Internet

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<sup>122</sup> Xenia Velez presentation to the Oversight Board (Nov. 30, 2017), 3

<sup>123</sup> IRS Enforcement Results, TIGTA Filing Season Audit, IRS Taxpayer Advocate, Team Analysis, GAO

<sup>124</sup> Hacienda, Fiscal Reforms August 2017 reporting

<sup>125</sup> Conversation with Hacienda, Dec 13, 2017

<sup>126</sup> <http://www.house.leg.state.mn.us/hrd/pubs/usetax.pdf> at 7

<sup>127</sup> Tech Crunch, 2016

sales.<sup>128</sup> In fact, Hacienda has already announced an agreement with a large online retailer to charge Puerto Rico sales tax on sales of goods.<sup>129</sup> With Internet sales growing at ~15% annually, Internet sales tax presents an even more important opportunity going forward.

Other best practices could be implemented as well. For example, Puerto Rico's SUT currently requires separate Commonwealth and municipal filings, but the filings could be consolidated and the revenue forwarded from the Commonwealth to the municipalities to ease compliance burden.<sup>130</sup> Similarly, multiple monthly SUT filings (up to 4 per month for importers) could be collapsed into one-time filings.<sup>131</sup>

Considering the post-hurricane limitations, additional compliance activities should be implemented beginning in FY2019, and would expect to see revenue impacts growing throughout FY2020 and beyond. The impact would phase in over the course of 4 years given the need for training and movement of workers into Hacienda through the Single Employer Act (Law 8, 2017), establishment of new offices and processes, and gradual shift in public perception and voluntary compliance as a result of enforcement activities. However, certain levers, such as negotiation of voluntary sales tax agreements with major online retailers, aside from Amazon, could begin as early as the end of FY2018.

#### *14.2.2 Right-rate other taxes and fees*

Prior to Hurricane Maria, the Government reports it had already developed a plan to right-rate the following taxes and fees. These original plans, as well as any adjustments mutually agreed upon between the Government and the Oversight Board during implementation of the March 2017 Fiscal Plan, have been largely included in this New Fiscal Plan, except where explicitly noted below. These plans should be implemented by FY2019.

**Gaming tax.** Legislation passed in 2017 that increased licenses and fees on mechanical and electronic gaming machines to \$3,000 from \$100. This was originally estimated to generate \$~71 million in incremental revenues.<sup>132</sup> Part of this calculation involved assumptions of improved enforcement improvements, as the Government has previously estimated it is losing approximately \$170 million per year due to illegal machines that are not paying licensing fees. However, when factoring in the potential that a 2,900% increase in taxes on the machines could decrease total revenues from gaming—a change from 2017 forecasting—run-rate incremental revenue from the gaming tax has now been reduced to approximately \$56 million per year by FY2023.

**Licenses and other fees.** 2017 legislation enabled fee increases in miscellaneous categories. Hacienda will determine which exact fees are to be increased to meet these minimum thresholds, achieving an overall revenue increase of ~\$70 million by FY2023.<sup>133</sup> Categories

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<sup>128</sup> Click Through refers to a nexus between an out of state seller and the state, which enables them jurisdiction to collect taxes, created via an affiliate in the state that links to another "out-of-state" business via an affiliate program (i.e., they send sales your way, you give them a small cut of the profits). Economic nexus refers to the dollar amount spent by a consumer at a business, which provides sufficient local economic activity for the state to be able to collect taxes from that out-of-state seller. Affiliate nexus refers to out-of-state sellers with ties to local sellers, such as through parent or subsidiary arrangements, or local order fulfillment, which creates sufficient local ties to subject the out of state seller to local taxes. Voluntary agreements occur when corporations agree through individual negotiations with states to collect and remit sales tax directly to the state

<sup>129</sup> Caribbean Business, "Amazon to charge Puerto Rico sales tax"

<sup>130</sup> Isabel Hernandez presentation to the Oversight Board (Nov 30, 2017), 13

<sup>131</sup> Ibid

<sup>132</sup> Based on an assumption of 23,000 gaming machines on which Hacienda is able to collect fees (<http://www.oslpr.org/2017-2020/leyes/pdf/ley-108-23-Ago-2017.pdf>)

<sup>133</sup> Assumes an 80% capture rate on the \$73M potential to account for potential elasticities in demand based on fee increases

are as follows: Charges for services; Fines; Insurance; Licenses; Permits; Rent; Royalties; Stamps; Other.

**Tobacco taxes.** Legislation was passed in 2017 to increase specific tobacco taxes, including taxes on cigarettes, cigars, rolling tobacco, cigarette paper and tubes, chewing tobacco, snuff, electronic cigarettes, nicotine cartridges, and vaporizers. Accounting for one-time declines in use due to price-related elasticities after the new fees went into place,<sup>134</sup> a ~\$60 million per year increase in revenues due to the new taxes is projected.

**Medical marijuana tax.** The Government has passed legislation to tax medical marijuana. Based on an estimated 29,000 patients, the Government can be expected to collect approximately ~\$15 million per year in additional revenue through this initiative.<sup>135</sup>

**Airbnb Tax.** The Government has passed a law to apply a 7% hotel room tax to Airbnb rentals, resulting in a projected ~\$4 million of annual revenue increases, based on annualization of the actual Airbnb tax receipts from before the hurricane.<sup>136</sup>

### 14.3 Implementation and enforcement of revenue measures

The following implementation plan details the continuation of the Commonwealth's efforts to increase compliance, and imposes further details on key milestones in the process to right-rate taxes and fees (**Exhibit 67**).

EXHIBIT 67: TAX COMPLIANCE AND FEES ENHANCEMENT KEY IMPLEMENTATION MILESTONES

Areas of focus	Action item	Deadline
Improve Compliance in Major Taxes (SUT, CIT, PIT)	Finalize integrated plan for compliance improvement across major tax types, including expected value from each	September 30, 2018
	Develop resource and milestone plan to support activities identified in the compliance improvement plan	October 31, 2018
	Launch acquisition activities (personnel, IT, external support) as needed to drive progress against key initiatives	October 31, 2018
	Continue monitoring performance of internet sales tax	Ongoing
Right-Rate Taxes and Fees	Initiate new gaming tax license collections and report on revenue yield	April 30, 2018
	Initiate new licenses and fees collections and report on revenue yield	June 30, 2018
	Apply local taxes to Airbnb rentals and report on revenue yield	March 31, 2019
	Continue collecting taxes on medical marijuana and report on revenue yield	Ongoing
	Continue collecting increased tobacco taxes and report on revenue yield	Ongoing
	Evaluate performance of added tax types; measure collections and compliance	June 1, 2022

#### 14.3.1 Creation of a tax expenditure report and regular reporting

As part of implementation, the Government must regularly produce a tax expenditure report, which will include a comprehensive list of revenue losses attributable to provisions of the Puerto Rican tax code that deviate from the tax structures benchmark law. Having a clear and accurate understanding of what the Government spends through tax expenditures is critical to ensuring the expenditures are contributing to economic growth and opportunity. The first draft of the tax expenditures budget must be provided to the Oversight Board by the end of calendar year 2018.

<sup>134</sup> Based on an 18% decline, per Hacienda (April 5, 2017 calculations)

<sup>135</sup> \$15M projected receipts, minus \$1.5M of dedicated revenues for the medical marijuana council established in 2017-Act 42 and controlled substances monitoring in 2017-Act 70

<sup>136</sup> Hacienda August 2017 Revenue Scorecard, submitted Sept 15, 2017

The tax expenditure report must include the cost of each tax expenditure for the current year and at least the prior two years. The report must also forecast the expected revenue collections and losses for at least the next five years from the date the report is produced. The forecast of revenue losses will include a comprehensive inventory of all tax credits, cash grants, deductions, exemptions, preferential tax rate, tax liability deferral and any other tax incentives where amounts allocated can materially impact the Commonwealth's financials.

The forecast of revenues losses should be constructed with considerations for tax benefits that are granted to large tax filers and corresponding impact on the Commonwealth's fiscal health. This report must include a year-end assessment of tax incentives granted to each intended target and a trend analysis of tax revenue collections, measured against historical and projected collections. The analysis will be used to forecast future tax expenditure budgets to ensure tax initiatives are optimized for economic growth and benefits the Commonwealth as a whole.

#### *14.3.2 Tax incentives code reform*

The current tax incentives code structure has high fiscal costs – in excess of \$400 million – but does not provide enough visibility to allow for clear tracking of these tax concessions and the returns they generate for the Puerto Rican economic growth. Past studies, based on limited economic data available, have indicated that while some tax incentives led to positive returns on investment, many others do not yield similar results.

The lack of transparency and high cost of these tax concessions warrant a reform in the tax incentives code. In addition to public disclosure of the amount and type of tax incentives awarded as part of the tax expenditure report, a value-for-money assessment for these tax concessions needs to be conducted to increase the rate of return on investment to Puerto Rico. Subsequently, based on the findings of this formalized assessment and explicit annual budget, the Government should implement a reform on the existing tax incentives code, to better align the tax concessions awards to the growth strategy of Puerto Rico.

#### *14.3.3 Principle of Revenue Neutrality*

Puerto Rico needs to drive toward more formality and increased compliance within the tax base, but it cannot lose revenues in the process. Therefore, any tax reform or tax law initiatives that the Government undertakes or pursues during a year within the New Fiscal Plan period must be revenue neutral, that is, all tax reductions must be accompanied by specific offsetting revenue measures of a sufficient amount identified in the enabling legislation. Each tax measure must also include confidence building elements, such as behavioral adjustments and reasonable capture rates. To ensure revenue neutrality, the implementation of any tax law initiatives must occur sequentially, with the Government ensuring that initiatives are paid for before rates are reduced.

Enforcement mechanisms must be part of any tax initiative package to prevent a scenario where tax reductions are not accompanied by sufficient offsetting revenue measures identified in the enabling legislation.

## Chapter 15. REDUCTION IN APPROPRIATIONS TO UPR AND MUNICIPALITIES<sup>137</sup>

### 15.1 Current state and vision for Commonwealth appropriations

The central Government provides a range of appropriations to three main groups of recipients: The University of Puerto Rico, Puerto Rico's 78 municipalities, and "other" recipients (typically private industry or non-profit institutions).

In FY2018, UPR was 67% subsidized (~\$678 million in annual appropriations) by state and local funds, compared to 25% average level of state/local subsidization of U.S. public universities<sup>138</sup>. UPR's tuition is less than one-third of the U.S. public average even after adjusting for per-capita income, and UPR spends ~10% more per student on operational spend than the average public university.

A reduction of the appropriation for UPR was determined in 2017 through a shared process with the Government to identify reasonable, sustainable reductions to the UPR appropriation that brought UPR closer to U.S. public university tuition and cost benchmarks. This reduction was included in the original March 2017 Fiscal Plan.

Municipalities receive \$220 million in annual appropriations from the Commonwealth, but despite this aid are operating at annual operating deficits of \$260M.<sup>139</sup> With more reductions on the horizon, municipalities must undergo substantial operating model changes, or else risk increasing their annual operating deficits to ~\$500 million annually. In addition to reducing the appropriations to municipalities to drive fiscal discipline, the Commonwealth can support consolidations of municipal services to encourage efficiencies, such as through service provision collectives or streamlining the legal framework to remove barriers to collaboration.

### 15.2 Key initiatives to reduce appropriations

Reducing Commonwealth subsidies to municipalities and UPR will lead to run rate savings of \$451 million by FY2023 (**Exhibit 68**)

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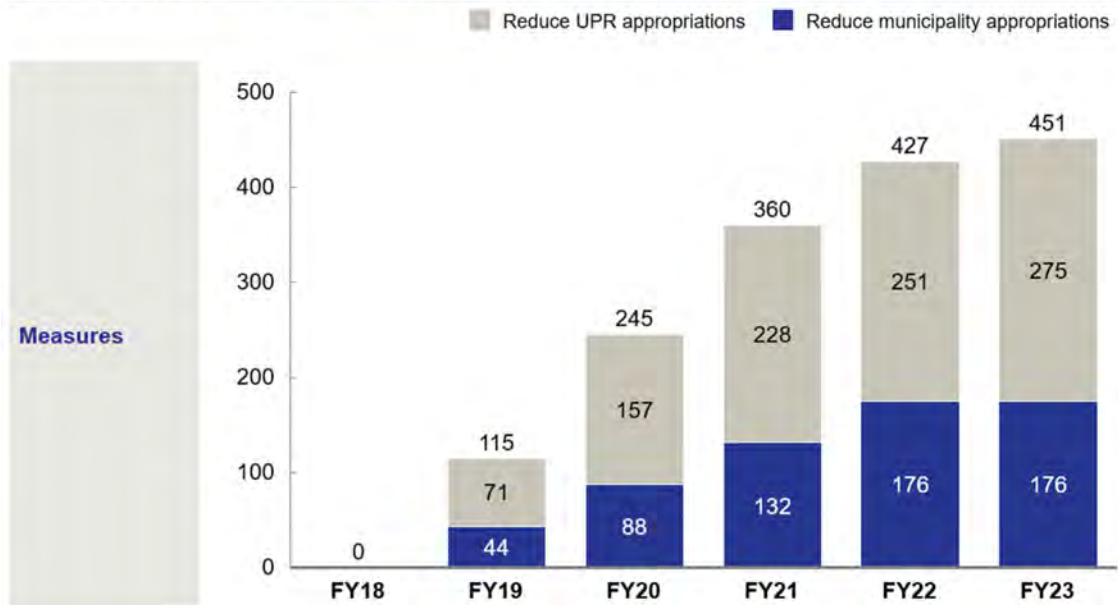
<sup>137</sup> Although the FOMB does not consider and has not considered anything in the New Fiscal Plan as a "recommendation" pursuant to Section 205(a), to the extent that the Government of Puerto Rico considers or has considered anything in this chapter a "recommendation" pursuant to Section 205(a), the FOMB hereby incorporates it into the New Fiscal Plan pursuant to Section 201(b)(1)(K)

<sup>138</sup> UPR, IPEDs, College Board

<sup>139</sup> V2A November 2016

EXHIBIT 68: REDUCTION IN APPROPRIATIONS MEASURES SUMMARY OF IMPACT

Summary of appropriations measures impact, \$M



*15.2.1 Reduce UPR appropriations to levels in line with funding of other U.S. public universities*

The New Fiscal Plan has maintained the March 2017 Fiscal Plan measures, less reductions to the appropriation that have already been factored into the FY2018 baseline, as well as reductions in addressable spend.

Targeted measures to increase revenues and reduce expenditures will allow UPR to operate sustainably under a reduced Commonwealth subsidy. On the revenue side, these include modestly raising tuition using a means-based approach (e.g., creating a means-based scholarship fund in parallel), applying more aggressively for federal grants (seeking to achieve funding equal to the level of 25<sup>th</sup> percentile of U.S. public universities), charging more dues and fees to students, applying for patents and other intellectual property, and continuing to provide trainings to the PRDE and the Government more broadly.

Expenditure reduction measures include consolidating campuses, optimizing HR through reducing temporary and trust positions, improving procurement, reducing the cost of medical insurance, and reducing tuition exemptions and special scholarships. These include identifying campuses and programs for consolidations based on performance metrics, tying personnel savings to roles implicated by campus consolidations and service reductions, reducing UPR employee pensions in a manner similar to the Commonwealth<sup>140</sup> and increasing tuition in future years to be roughly equivalent to federal Pell grant less a reasonable contribution to cost of living and other related expenditures.

These efforts to improve the operations of UPR will in turn allow the University to renew its operating model to provide the best outcomes for its students. These outcomes will include reduced time to degree, improved job placement, and higher standardized test scores, among

<sup>140</sup> Additionally, the New Fiscal Plan for the University of Puerto Rico includes a 50% employer match (by UPR) on up to 2% of employee contribution

others. A re-envisioned University, which focuses on areas of strengths and on improving outcomes for students, will ultimately prove to be a critical source of renewal for the Island, as it is a cornerstone of human capital development to propel growth in the economy.

### *15.2.2 Establish independent scholarship fund for UPR*

A means-based scholarship fund for UPR will be supported by reductions to the budgets of the Oversight Board, Legislative Assembly, and AAFAF. These reductions should generate \$35-37 million annually in reinvestment funds from FY2019 through FY2023, and they will be used to help build up an endowment to pay for need-based scholarships for UPR students. Specifically, the savings will fund an independent endowment for needs-based scholarships for students at UPR, which will be managed by Hacienda (OCFO).

### *15.2.3 Reduce municipal appropriations & support through service consolidation and property registry / tax reform*

To incentivize municipal operational changes, the Commonwealth must reduce the current level of municipal appropriations. Already in FY2018, the total municipal appropriation was reduced by \$150 million, bringing the new baseline appropriations to ~\$220 million per year. Going forward from this current baseline, there must be a reduction in each successive year, holding appropriations constant at roughly 45-50% of current levels starting in FY2022 before ultimately phasing out all subsidies in FY2024.

The slow ramp in reductions will allow the remaining funds to be used to fund shared service consolidations. Two levers in particular should enable municipalities to become solvent: municipal service consolidations and institution of property tax reform.

#### *Municipal service consolidations*

Consolidating services across multiple municipalities can help reduce cost by leveraging scale, especially in areas of services provided directly to citizens, including public works and infrastructure, public safety, family services, education, and housing. Prior to Hurricanes Irma and Maria, Estudios Técnicos estimated that operating expenditure reduction measures, in part from municipal service sharing, could result in a potential combined fiscal impact of ~\$150-\$450M.<sup>141</sup>

The Commonwealth should pursue several initiatives to incentivize and streamline consolidation:

- Offer financial incentives (e.g., remaining municipal subsidy) for municipalities who hit targets
- Provide transparency into service performance by creating performance metrics and publishing the results, benchmarked against peer municipalities
- Develop and operate service provision collectives across counties
- Streamline legal frameworks to remove any barriers to collaboration between municipalities (e.g., liability issues); for example, the Government can pass legislation like New Jersey's 2007 Uniform Shared Services and Consolidation Act to formalize accountability for pursuing shared services by placing the onus on local leadership<sup>142</sup>

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<sup>141</sup> "Estudio para evaluar la estructura municipal de Puerto Rico", Estudios Técnicos (2016)

<sup>142</sup> New Jersey Department of Community Affairs, *Shared Services – Working Together*. April 2011  
[http://www.nj.gov/dca/divisions/dlgs/programs/shared\\_docs/sharedsvcsrefguide.pdf](http://www.nj.gov/dca/divisions/dlgs/programs/shared_docs/sharedsvcsrefguide.pdf)

### *Property tax reform*

In partnership with the Municipal Revenues Collection Center (CRIM), the municipalities should identify and register tens of thousands of non-registered properties to begin collecting tax on them,<sup>143</sup> and re-categorize misclassified properties (e.g., residential properties marked as commercial). Additionally, CRIM can streamline collection activities and use proven compliance practices, such as advanced analytics to identify non- or under-payment, to raise payment rates. Based on implementation planning discussions in August 2017, CRIM estimated these initiatives could produce:<sup>144</sup>

- \$150 million of increased revenue from raising property tax compliance from 68% to 85%
- \$150-200 million from registering properties not on the rolls
- \$500 million of capturable back property taxes owed (from \$1.3 billion total owed)
- Lastly there is an additional, not yet sized, opportunity from reclassifying commercial properties incorrectly listed as residential and updating property valuations

## Chapter 16. PENSION REFORM<sup>145</sup>

### 16.1 Current state of and required changes to pension reform

The Government operates three public employee retirement systems in Puerto Rico: the Employees' Retirement System (ERS), the Teachers' Retirement System (TRS), and the Judicial Retirement System (JRS). The plans have different tiers of benefit formulas, some of which are traditional defined benefit pensions based upon years of service and final salary, while others are hybrid cash balance plans. Under the hybrid cash balance plans, employees have notional accounts credited with contributions and interest, and upon retirement, benefits are payable as an annuity. Different benefit tiers apply to employees based upon the year in which they were hired. Per the latest data available, each of the systems included the following liabilities<sup>146</sup>:

- ERS: 245,000 total covered (120,000 active employees, 125,000 retirees and other beneficiaries); with \$1.7 billion in annual benefits and \$38 billion in total actuarial liability
- TRS: 80,000 total covered (38,000 active employees, 42,000 retirees and other beneficiaries); with \$0.8 billion in annual benefits and \$18 billion in total actuarial liability
- JRS: 860 total covered (371 active employees, 487 retirees and other beneficiaries); with \$28 million in annual benefits and \$0.7 billion in total actuarial liability<sup>147</sup>

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<sup>143</sup> Many homes in Puerto Rico have not been registered with the Government, which has led to difficulties for thousands in receiving assistance from FEMA's Individual Housing Program. For example, as of mid-January 2018, 62% of the 1.1 million applications for disaster assistance has been either rejected or were still "in-process", often due to lacking registration and title deeds ("Majority of Claimants in Puerto Rico Still Await Assistance from FEMA, Many Found 'Ineligible'", Caribbean Business)

<sup>144</sup> Meetings with CRIM leadership on July 19, 2017

<sup>145</sup> Although the FOMB does not consider and has not considered anything in the New Fiscal Plan as a "recommendation" pursuant to Section 205(a), to the extent that the Government of Puerto Rico considers or has considered anything in this chapter a "recommendation" pursuant to Section 205(a), the FOMB hereby incorporates it into the New Fiscal Plan pursuant to Section 201(b)(1)(K)

<sup>146</sup> All liability estimates are as of July 1, 2016, and benefit estimates are for FY2018, but based on census data as of July 1, 2015

<sup>147</sup> The total actuarial liability is approximately \$658 million as described in the following: [www.retiro.pr.gov/wp-content/uploads/PRJRS\\_Val\\_June302016.pdf](http://www.retiro.pr.gov/wp-content/uploads/PRJRS_Val_June302016.pdf)

**All employees make contributions toward their benefits, albeit at different rates.** Most regular government employees also participate in Social Security, which includes both employer and employee contributions; most teachers, judges, and police officers do not (**Exhibit 69**).

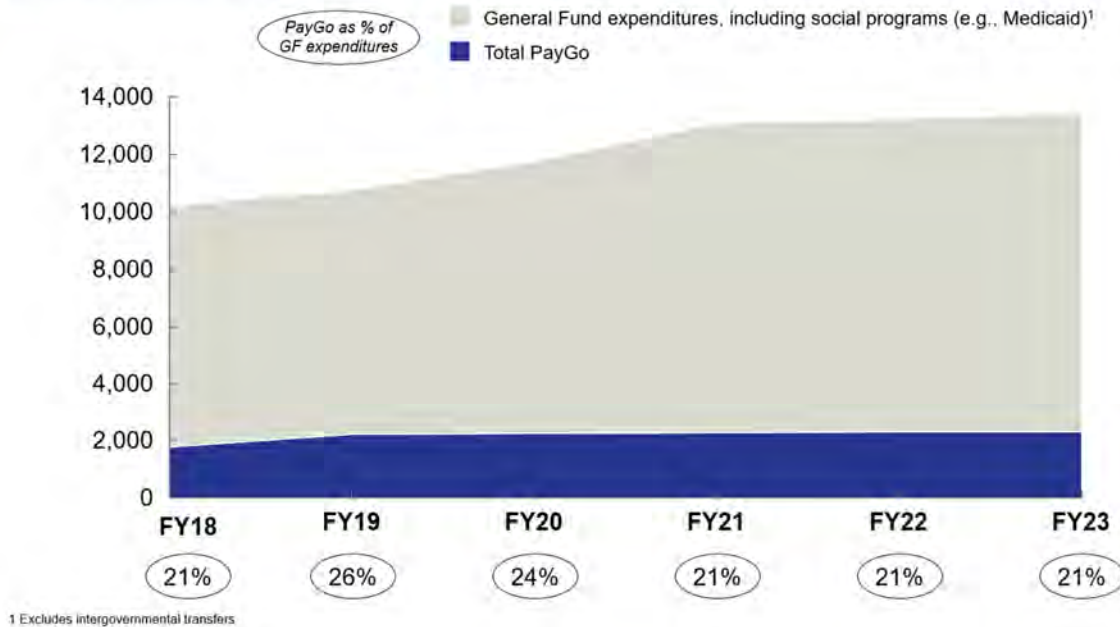
EXHIBIT 69: PUBLIC EMPLOYEE RETIREMENT SYSTEMS OVERVIEW

Group	Defined Benefit Component	Hybrid Cash Balance Component	Social Security Coverage
ERS - Hired Jan 1, 2000 or later	None	Based on employee contribution and a share of investment earnings	Police – No Others – Yes
ERS - Hired before 2000	Based on years of service and salary, frozen as of 2013	Based on employee contribution since 2013 and a share of investment earnings	Police – No Others – Yes
TRS - Hired Aug 1, 2014 or later	None	Based on employee contribution and a share of investment earnings	No
TRS – Hired before Aug, 2014	Based on salary and years of service	None	No
JRS - Hired July 1, 2014 or later	Reduced formula based on salary and years of service	Based on employee contribution and a share of investment earnings	No
JRS — Hired before July 1, 2014	Based on salary and years of service	None	No

**Over many decades, successive governments have failed to adequately fund these retirement plans, and today the ERS, TRS and JRS are nearly insolvent.** In fact, PayGo expenditures to provide pension benefits have been increasing in recent years, and are expected to constitute approximately 1/5 of General Fund expenditures without further action, as detailed below (**Exhibit 70**).

EXHIBIT 70: PAYGO EXPENDITURES COMPARED TO OVERALL GENERAL FUND  
EXPENDITURES, PRE-MEASURES

PayGo expenditures compared to overall General Fund expenditures, \$M



These retirement plans will soon deplete the assets they use to pay benefits. Without action, this could lead to large benefit cuts for all retirees. Such benefit cuts would not only be devastating to current retirees and their families, but would adversely impact Puerto Rico's economy as retirees spend virtually all their income on the Island. **There must be adequate funding for pension systems, such that the retirement systems promise benefits Puerto Rico can afford and the Government funds the revised benefits.**

The Commonwealth has already taken critical steps toward a more stable pension system through legislation passed from 2013 through 2017 that ceased accruals under the unsustainable ERS and TRS defined benefit (DB) plans (though TRS reform was partially overturned). In addition, the Commonwealth transitioned to a new "PayGo" pension system, liquidating assets to help fund benefits owed, and the Commonwealth also committed to moving all active ERS members and recently hired TRS members into segregated true defined contribution (DC) retirement plans. However, there is a need for further action to ensure the long-term sustainability of the pensions system; in addition, some of the current commitments have not yet been fulfilled (e.g., the transition to the new defined contribution system has not yet been completed).

Therefore, Puerto Rico's retirement system must be further reformed to reduce costs, restore the plans to financial sustainability, and maintain responsible *funding policy* for current and future retirees. The overhauls will have an average \$180 million annual impact through FY23. Over the life of the plan, this results in more than \$5 billion in savings in present value terms.<sup>148</sup> Reductions to benefits must also be structured to **protect lower-income retirees**, who otherwise could become impoverished and therefore be forced to rely upon government "safety net" benefits.

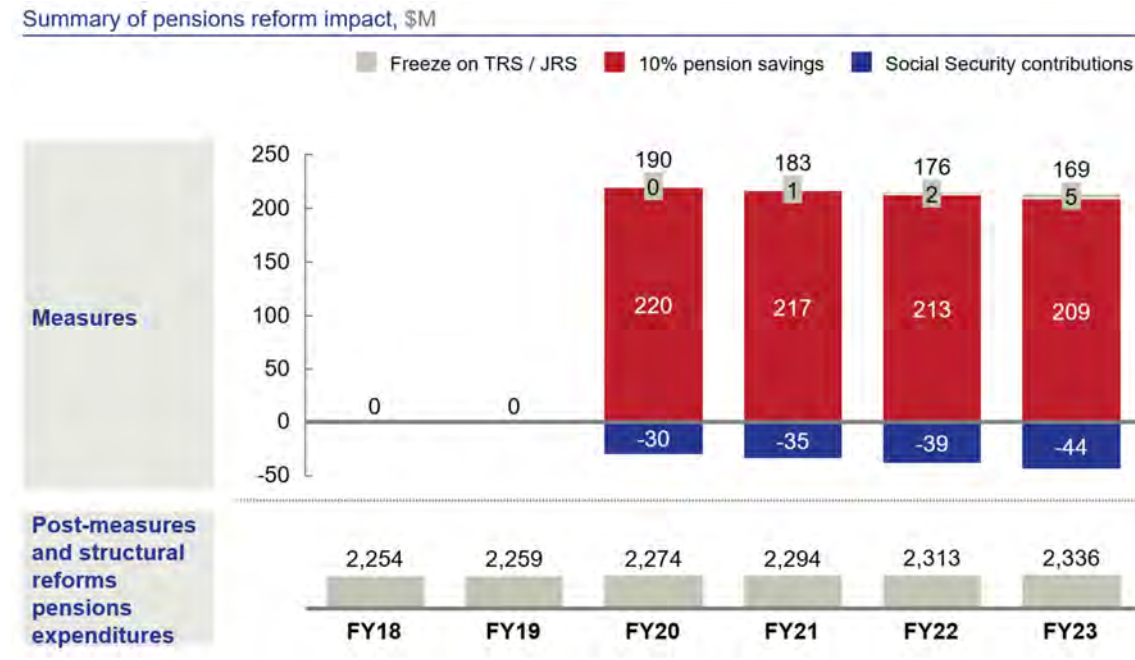
<sup>148</sup> Previous versions of the Fiscal Plan listed \$11B, but a technical adjustment to the baseline was required as past mismanagement of teacher contributions should not be assumed for future years, and therefore are included in the baseline

**Pension reform will help restore both fiscal balance and promise for current and future retirees from government.**

## 16.2 Proposed pension reform initiatives

Restructuring and stabilizing the pension system must lead to \$719 million in savings over six years, as shown below (**Exhibit 71**).

EXHIBIT 71: PENSIONS REFORM SUMMARY OF IMPACT



### 16.2.1 Freeze DB accumulation for JRS/TRS and enroll employees in a DC plan with segregated accounts

TRS members hired prior to August 1, 2014 and JRS members hired prior to July 1, 2014 are currently accruing benefits under their defined benefit retirement plans. ERS members have already transitioned to hybrid cash balance plans (in 2000 and 2013), with a transition to DC accounts targeted for July 2019.<sup>149</sup> To avoid creating future pension liabilities and to stabilize the system for the benefit of both taxpayers and future retirees, the JRS and TRS plans' benefit accrual must be frozen by July 1, 2019. Members will retain the benefits they have accrued to date, subject to the benefit reduction formula discussed below. Future benefits must be based on contributions and earnings in new defined contribution retirement accounts. This will result in consistent treatment across ERS, TRS, and JRS, where employees will contribute to segregated DC accounts rather than notional accounts. Going forward, employees should have the certainty that their contributions and investment returns will be safeguarded for the future, ensuring retirement security.

Although in the early years the DB freeze savings are small (\$0.32 million in FY2020), over time the freeze should produce significant savings (almost \$20 million in FY2026 and growing further in later years to more than \$200 million) and play a significant role in restoring the budget to long-term sustainability. The freeze will be implemented through the Plan of

<sup>149</sup> Estimate provided by AAFAF in February 2018

Adjustment, and is slated to take effect starting in FY2020 so that needed changes can be implemented.

### *16.2.2 10% pension benefit reduction*

Expenditures are being reduced throughout the Commonwealth's budget and contractual debt service remains unaffordable. Retirement plan participants, like other unsecured claimholders, face a reduction in the amounts paid to them by the Commonwealth. A 10% average reduction in pensions is appropriate and necessary. The goal is a balanced approach to restore fiscal health to Puerto Rico while ensuring that cuts to retirement benefits occur in a progressive matter that protects any retirees from falling into poverty. The level of cuts to pension benefits is also in line with reductions in other government systems facing pension funding crises.<sup>150</sup>

Although the average benefit reduction will be 10%, there will be no reduction for those with total retirement plan benefits (including assumed Social Security of \$400 for non-police ERS members for whom the employer pays Social Security taxes) below the poverty level of \$1,000 per month.<sup>151</sup> This formula is equivalent to giving each beneficiary a reduction of 25% in the monthly benefits they receive in excess of \$600 or \$1,000<sup>152</sup>. These dollar figures will be adjusted in future years consistent with increases in the federal poverty threshold.

Under this approach, **about 25% of retirees would receive no reduction in their benefits and an additional 18% of retirees will experience a benefit reduction of 5% or less.** Therefore, in total, approximately 60% of retirees will experience a benefit reduction of 10% or less, and over 80% of retirees will experience a benefit reduction of 15% or less. Very few retirees will have more than a 20% reduction, and none will have a reduction of 25% or more (**Exhibit 72**).

This formula will also apply to benefits earned by current employees who have yet to retire.

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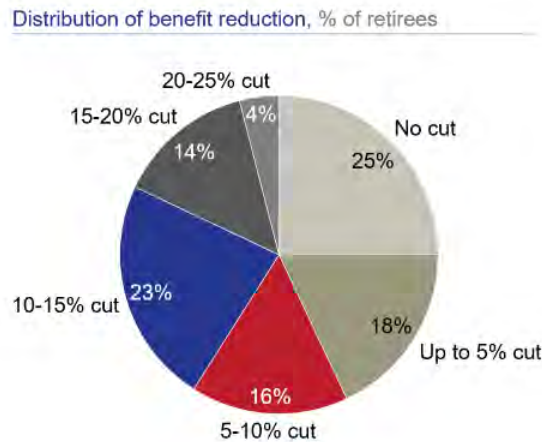
<sup>150</sup> For example, in Detroit and Rhode Island, pension cuts ranged from 0-30% across beneficiary categories

<sup>151</sup> Actuarial calculation show that the following approach will result in reductions averaging 10%:

- Determine the average monthly pension by adding the regular monthly pension amount, the special law pension, the healthcare bonus, and one-twelfth of the Christmas Bonus and Medicine Bonus;
- Reduce these monthly benefits by 25%; and
- Add back up to \$150 per month (\$250 per month for those who are not covered by Social Security) to reduce the effect of benefit reductions for those with the lowest benefits

<sup>152</sup> Reduction (not less than zero) =  $25\% \times \text{Benefit} - 25\% \times (1,000 \text{ if Police/TRS/JRS or } \$600 \text{ if ERS non-Police})$ . For example, if ERS benefit (in Social Security) is \$2,000, then reduction =  $25\% \times 2,000 - 25\% \times \$600 = \$500 - \$150 = \$350$ . Actual Social Security benefits will not be considered. The calculation simply uses \$600 for ERS members other than police and \$1,000 for all others.

## EXHIBIT 72: DISTRIBUTION OF BENEFIT REDUCTION



The 10% reduction shall take effect starting in FY2020 to have sufficient time to implement it following the Plan's enactment.

Because the poverty threshold is anticipated to increase faster than frozen pension benefits and the size of the frozen benefits will decline as the number of years accrued before the freeze decreases (when the youngest workers who still had DB plans begin to retire), the 10% target overall savings rate will fall over time, eventually reaching less than 1% by about 2050.

### *16.2.3 Covering more government workers in Social Security*

Currently, teachers, police officers, and judges do not participate in Social Security. They do not pay into the program, nor does the Government make a Social Security contribution on their behalf. Teachers, police officers and judges are also not eligible for benefits at retirement. Unlike other ERS members, teachers, police officers, and judges are entirely reliant on their government pensions for income in retirement. This places them at risk when government retirement plans are poorly funded.

These groups are exempt from Social Security because of the "Section 218" agreement between the Commonwealth and the Social Security Administration, which stipulates that government employees may be exempt from Social Security if they participate in a "comparable" retirement plan such as one which includes total employee and employer contributions equal to at least 7.5% of employee wages.

Covering these workers under Social Security will provide them with diversified sources of income in retirement, and Social Security's progressive benefit formula will provide a stronger safety net for lower-paid employees. Workers will typically earn greater retirement benefits under Social Security based on a 6.2% employee contribution and a 6.2% employer (government) match, than they would funded only with a 6.2% DC. For example, a typical full-career government employee retiring with a salary of \$35,000 will be entitled to a Social Security benefit of approximately \$16,000, in addition to the benefit the employee builds in their defined contribution retirement account.

Social security retirement benefits are only provided for those that have ten years of covered earnings. Therefore, it would not be worthwhile for older workers who may not meet the ten-year threshold to be covered under social security. For this reason, police, teachers, and judges *under the age of 40* shall be covered under Social Security. This can be accomplished without either an employee referendum or new federal legislation by reducing pension contributions

for government employees under the age of 40 to an amount lower than the 7.5% required by Section 218. This step will trigger mandatory enrollment in Social Security. Concurrently, lowering the pension contribution for younger workers will address the loss of take-home pay they would suffer by having to pay the 6.2% Social Security payroll tax.

For example, teachers over the age of 40 will contribute 13.12% of their pay to their defined contribution plan. The changes to Social Security enrollment will create a second DC plan for teachers under 40, with a mandatory employee contribution rate of only 6.92% of their pay. Since this contribution rate is less than the requirement of a 7.5% contribution, these younger workers legally must be enrolled in Social Security. However, the 6.2% reduction in the pension contribution rate from 13.12% to 6.92% would protect these employees against any reduction in their take-home pay.

As requested by the Governor, the New Fiscal Plan includes the enrollment of police under the age of 40 in Social Security beginning in FY2019 instead of FY2020; however, this requires the Government to first timely implement certain changes to police pension programs.

At a further date, the Commonwealth may wish to take the necessary steps to provide the option for police, teachers, and judges, over the age of 40 to be covered under social security.<sup>153</sup>

### 16.3 Implementation and enforcement of pensions measures

While the new pensions measures will only go into effect starting on July 1, 2019, advance work will be necessary to prepare the systems for the JRS / TRS freeze and pensions reductions, as well as ensuring communications with all Puerto Rican pension recipients (**Exhibit 73**).

EXHIBIT 73: PENSIONS REFORM KEY IMPLEMENTATION MILESTONES

Areas of focus	Action item	Deadline
Shift to Defined Contribution Accounts	Pass legislation for JRS / TRS freeze and transition to segregated DC accounts	December 31, 2018
	Transition hybrid accounts to segregated DC accounts	July 1, 2019
	Implement JRS / TRS freeze and transition to segregated DC accounts	July 1, 2019
Reduction in Pension Benefits	Pass legislation for 10% average pension reduction	December 31, 2018
	Implement 10% average pension reduction	July 1, 2019
Social Security	Pass legislation for enrollment of police under 40, as well as all new hires, in Social Security	June 30, 2018
	Enroll police under 40, as well as all new hires, in Social Security	September 30, 2018
	Pass legislation for enrollment of teachers and judges under 40, as well as all new hires, in Social Security	December 31, 2018
	Enroll teachers and judges under 40, as well as all new hires, in Social Security	July 1, 2019

## Chapter 17. ENSURING SUCCESSFUL IMPLEMENTATION AND FISCAL CONTROLS

Historically, the Government has suffered from inconsistent execution due in part to not having a defined, centralized project management structure. It has historically operated in silos, suffered staffing and coordination challenges, and has been limited by weak technology

<sup>153</sup> This would require federal legislation, extensive communications, and a Section 218 divided vote referendum.

that prevents the ability to report and keep track of expenditures. To mitigate implementation risk and improve fiscal management, the Oversight Board expects there to be a robust and well-resourced PMO structure, clear implementation plans with milestones and key progress indicators, and regular fiscal controls and reporting. These functions will largely be the responsibility of the Office of the CFO.

## 17.1 Implementation architecture

Developing a centrally-run PMO is an important step toward ensuring the implementation and tracking of the core operational transformation and agency efficiency measures that will achieve savings targets under the New Fiscal Plan. The OCFO is the central PMO with defined reporting to the Governor of all economic and transformation measures. It is comprised of senior leadership, oversees Agency PMOs, and reports directly to the Governor's appointed Fiscal Economic Working Group (FEWG). At the time of writing, the OCFO PMO and the FEWG has already been established and is leading implementation.

Individual Agency PMOs should be established with direct reporting to the OCFO. Each agency head shall be responsible for developing and implementing a PMO structure that best fits their respective agency while still meeting their agency grouping savings targets. Through this PMO structure, the Government is positioned to effectively manage and implement the Fiscal Plan.

- The Agency PMOs are generally led by designated Agency Heads and report directly to the OCFO
- Agency PMOs undertake the required work to implement initiatives
- The daily activities of PMOs are managed and undertaken by staff knowledgeable in the relevant subject matter areas, and assigned members meet regularly with PMO leadership to report on progress and facilitate necessary decision-making
- Agency PMOs shall be responsible for assembling a taskforce to: complete validation and definition of full scope of projects and priorities; finalize reporting tools and tracking responsibilities; and, perform ongoing weekly tracking and reporting.

The PMOs should ensure continued implementation progress through robust tracking and reporting tools that foster growth in transparency and ownership, including:

- **Project charters** that establish the goals / structures of measures, identifies risks and obstacles, and establishes metrics and KPIs
- **Implementation plans** with detailed layouts of each activity required for accomplishing sub-measures, risks / mitigants for each activity, clear leaders and owners for each activity, and metric and KPIs. These should include a “live” calendar of updates and status of each measure. If an activity goes behind schedule, the workplan will reflect that the activity is still in progress.
- **Implementation dashboard / tracker** that provides a single snapshot of the entire transformation plan; allows management to know the status of each initiative in a distinct status: Complete; In Progress; Delays; Major Issues. Tracker will allow the Oversight Board to monitor progress and ensure enforcement of measures/ reforms in the New Fiscal Plan.
- **Sub-measure dashboards** that provide “zoomed in” views of a specific sub-measure, display progress with details / commentary on project status, include agreed upon milestones / dates to track progress, and provides mitigation plans

## 17.2 FOMB and OCFO implementation collaboration

The Oversight Board will play an active role in overseeing implementation of all aspects of the New Fiscal Plan. OCFO must provide the Oversight Board and its staff the information needed to effectively track status of key initiatives included in the plan, which is necessary to measure overall progress against the fiscal and budget objectives outlined in the plan.

For example, OCFO will provide FOMB staff with key management artifacts on a timely basis, including:

- Implementation plans submitted by individual PMOs
- Progress reviews (including milestones and metrics) against key structural and fiscal measures
- Review of key implementation risks, including assessment of likelihood of realization, potential impact, and potential mitigations

## 17.3 Fiscal controls and transparency

As part of implementing the New Fiscal Plan, the Oversight Board will require public reporting of the Government's data regarding finances and budget to improve fiscal governance, accountability, and internal controls. Further, it will ensure that the budget is a robust document for driving change, and that there is transparency into the Government's progress toward meeting its savings targets. As such, the Government will be expected to meet the following milestones. (**Exhibit 74**)

EXHIBIT 74: FISCAL CONTROLS AND REPORTING KEY IMPLEMENTATION MILESTONES

	Reporting Requirement	Closing of the 1st Reporting Period	Cadence for FOMB Reporting *	Cadence for Public Reporting *	Reporting Requirement Source
I. Cash Reporting	A. Treasury Single Account (TSA) Liquidity (Actuals vs. Liquidity Plan)	10/28/2018	Weekly; Monthly	Weekly; Monthly	Fiscal Plan
	B. Consolidated TSA including Agency Detail (Actuals vs. Liquidity Plan)	10/31/2018	Monthly	Monthly	Fiscal Plan
	C. Independently Forecasted Component Units (IFCUs) (Actuals vs. Liquidity Plan)	10/31/2018	Monthly	Monthly	Fiscal Plan
	D. Liquidity - Office of the Comptroller, Senate, House of Representatives, Judiciary Branch, Civil Rights Commission, OMBUDSMAN (Actuals vs. Liquidity Plan)	10/31/2018	Monthly	Monthly (beginning 11/30/18)	Fiscal Plan
	E. Summary of Bank Account for the Government of Puerto Rico and its Instrumentalities	10/31/2018	Monthly	Monthly	Fiscal Plan
II. Additional Reports Reporting	A. Monthly Budget to Actual Report - Including Revenues <sup>1</sup>				
	1. General Fund	10/31/2018	Monthly	Monthly	Fiscal Plan
	2. Non-General Fund Funds (including Special Revenue Funds) <sup>2, 3</sup>	10/31/2018	Monthly	Monthly (beginning 1/31/19)	Fiscal Plan
	3. Federal Funds <sup>4</sup>	10/31/2018	Monthly	Monthly (beginning 1/31/19)	Fiscal Plan
	4. IFCUs	10/31/2018	Monthly	Monthly (beginning 1/31/19)	Fiscal Plan
	5. Comptroller, Senate, House of Representatives, Judiciary, Civil Rights Commission, OMBUDSMAN	10/31/2018	Monthly	Monthly (beginning 11/30/18)	Fiscal Plan
	B. Central Government Payroll and Headcount <sup>5</sup>	10/31/2018	Monthly	Monthly	Fiscal Plan
	C. IFCU Payroll and Headcount <sup>6</sup>	10/31/2018	Monthly	Monthly	Fiscal Plan
	D. Central Government 3rd Party Accounts Payable	10/28/2018	Weekly; Monthly	Weekly; Monthly	Fiscal Plan
	E. Central Government Invoice Processing KPIs	10/31/2018	Monthly	Monthly (beginning 11/30/18)	Fiscal Plan
	F. Tax Credits	-	-	-	Fiscal Plan
	1. Liability	12/31/2018	Quarterly	Quarterly (beginning 1/31/19) <sup>c</sup>	Fiscal Plan
	2. New credits granted	10/31/2018	Monthly	Monthly (beginning 1/31/19) <sup>c</sup>	Fiscal Plan
	3. Credits used (direct impact on collections)	12/31/2018	Yearly	Yearly <sup>c</sup>	Fiscal Plan
	4. Tax Expenditure Report	12/31/2018	Yearly	Yearly	Fiscal Plan
	G. OATRHS Attendance for the Preceding 4-Week Period	12/31/2018	Yearly	Yearly	Fiscal Plan
	H. Quarterly budget to actual revenues, expenditures, and cash flows, together with a variance analysis, of the territorial government during the preceding quarter	10/31/2018	Monthly	Monthly	Fiscal Plan
III. Measures and Reforms Reporting (Progress Reports) <sup>7, 8</sup>	A. Structural Reforms (4)				
	1. Labor Reform	10/31/2018	Monthly	Quarterly	Fiscal Plan
	2. Ease of Doing Business Reform	10/31/2018	Monthly	Quarterly	Fiscal Plan
	3. Energy Reform	10/31/2018	Monthly	Quarterly	Fiscal Plan
	4. Infrastructure Reform	10/31/2018	Monthly	Quarterly	Fiscal Plan
	B. Fiscal Measures (4)				
	1. Office of the Chief Financial Officer	10/31/2018	Monthly	Quarterly	Fiscal Plan
	2. Revenue Measures	10/31/2018	Monthly	Quarterly	Fiscal Plan
	3. Pension Reform	10/31/2018	Monthly	Quarterly	Fiscal Plan
	4. Healthcare Reform	10/31/2018	Monthly	Quarterly	Fiscal Plan
	C. Agency Efficiencies				
	1. Agriculture (3 agencies)	10/31/2018	Monthly	Quarterly	Fiscal Plan
	2. Corrections (2 agencies)	10/31/2018	Monthly	Quarterly	Fiscal Plan
	3. Culture (3 agencies)	10/31/2018	Monthly	Quarterly	Fiscal Plan
	4. Economic Development (11 agencies)	10/31/2018	Monthly	Quarterly	Fiscal Plan
	5. Environmental (4 agencies)	10/31/2018	Monthly	Quarterly	Fiscal Plan

	Reporting Requirement	Closing of the 1st Reporting Period	Cadence for FOMB Reporting *	Cadence for Public Reporting *	Reporting Requirement Source
II. Measures and Reforms Reporting (Programs Reports) (cont'd)	8. Executive Offices (8 agencies)	10/31/2018	Monthly	Quarterly	Fiscal Plan
	7. Finance Commission (2 agencies)	10/31/2018	Monthly	Quarterly	Fiscal Plan
	8. Office of the CFO ( 6 agencies)	10/31/2018	Monthly	Quarterly	Fiscal Plan
	9. Healthcare (7 agencies)	10/31/2018	Monthly	Quarterly	Fiscal Plan
	10. Justice (2 agencies)	10/31/2018	Monthly	Quarterly	Fiscal Plan
	11. Labor (5 agencies)	10/31/2018	Monthly	Quarterly	Fiscal Plan
	12. Land (2 agencies)	10/31/2018	Monthly	Quarterly	Fiscal Plan
	13. Ombudsman (5 agencies)	10/31/2018	Monthly	Quarterly	Fiscal Plan
	14. Public Safety (6 agencies and 1 program)	10/31/2018	Monthly	Quarterly	Fiscal Plan
	15. Public Works (4 agencies)	10/31/2018	Monthly	Quarterly	Fiscal Plan
	16. Social Welfare (8 agencies)	10/31/2018	Monthly	Quarterly	Fiscal Plan
	17. State (2 agencies)	10/31/2018	Monthly	Quarterly	Fiscal Plan
	18. Universities (2 agencies)	10/31/2018	Monthly	Quarterly	Fiscal Plan
	19. Utilities Commission (4 agencies)	10/31/2018	Monthly	Quarterly	Fiscal Plan
	20. Independent Agencies (20 agencies)	10/31/2018	Monthly	Quarterly	Fiscal Plan
IV. Macroeconomic Indicators	Macroeconomic Indicators	12/31/2018	Quarterly	Quarterly	Fiscal Plan
V. Recovery Funding Reporting	A. Uses/Disbursement Related to Hurricane Assistance (PWs)	10/31/2018	Monthly	n/a	Fiscal Plan
	B. Department of Housing	10/31/2018	Monthly	n/a	Fiscal Plan
	C. Highways and Transportation Authority	10/31/2018	Monthly	n/a	Fiscal Plan
	D. TSA Vendor Disbursements	10/31/2018	Monthly	n/a	Fiscal Plan
VI. PayGo Receivables and Contributions Reporting	PayGo Receivables and Contributions Reporting	10/31/2018	Monthly	Monthly	Fiscal Plan
VII. Certifications and Others	A. Quarterly revenue forecast update	10/31/2018	45 days after end of every quarter	n/a	Budget
	B. Certify that no appropriation of any previous fiscal year (except for appropriations covered by the exceptions authorized in the budget) has been used to cover any expense during the prior fiscal quarter	12/31/2018	15 days after end of every quarter	n/a	Budget
	C. Certify that no amount of the (i) Social Security Reserve or (ii) Emergency Reserve has been used to cover any expenses during the prior fiscal quarter	12/31/2018	15 days after end of every quarter	n/a	Budget
	D. Payroll transfers per Law 8-2017	12/31/2018	Monthly	n/a	Fiscal Plan
	E. Signed legislation Compliance Certificates	n/a	7 days after a bill is signed by the Governor	n/a	FROMESA
	F. Sabana file submission	n/a	n/a	n/a	Budget
	G. Quarterly budget submission	n/a	n/a	n/a	Budget

**Footnotes**

- 1 Revenues must include gross revenues received, less tax refunds; SRF revenues must be included.
- 2 The following fund types are included in non-GF reporting: (1) FEE (Fondos Especiales Estatales or Special State Funds) - This fund type should only include revenue designated by specific laws; (2) OI (Otros Ingresos or Other Income) - This fund type should only include non-recurring revenue with specific expenses tied to it. No recurring income should be included or recognized under this fund type OI; and (3) IP (Ingresos Propios or Own Income) - This fund type should only include revenue generated by the agencies or public corporation through their services.
- 3 The monthly deliverable must include: (1) All revenues and expenses for the current FY; (2) The cash balance for each fund type as of the beginning of the Fiscal Year; (3) The new cash earned during the current fiscal year; and (4) the net cash balance.
- 4 The monthly deliverable must include a list of all Awards by Agency; additionally, next to each Award please include: (1) Date Award was granted; (2) Date Award expires/renews; (3) Total Award amount (split into payroll/non-personnel); (4) Total Award expenses from prior fiscal years (split into payroll/non-personnel); (5) Total Award expenses for the current fiscal year (split into payroll/non-personnel); and (6) Total remaining Award amount (split into payroll/non-personnel).
- 5 The report must include (1) the fund type; (2) overtime amounts; and (3) the breakdown of benefits.
- 6 Implementation plans must be provided for each agency under each agency grouping; the full list of the agencies is included in the Appendix of the Fiscal Plan.
- 7 Reporting must include:
  - (a) Monthly monitoring by each government agency of key performance indicators for each of the fiscal reform measures.
  - (b) Monthly self reported realized savings achieved year to date by agency and agency groupings.
  - (c) Implementation dashboard / tracker that provides status of each initiative in a district status.
  - (d) Sub-measures dashboard.
- A. Unless otherwise specified, monthly reporting to the Oversight Board must be received 15 days after the end of a reporting period.
- B. Unless otherwise specified, public reporting must be published 30 days after the end of a reporting period.
- C. Report shall be structured in a way that allows for the confidentiality of the agreements to be maintained, but the overall (summarized) numbers and trends to be available to the public.

In addition to meeting the above milestones, the Government must proceed according to the following budgetary requirements:

- The Department of the Treasury will remit to the Legislative Branch and its components, to the Judiciary, to the University of Puerto Rico, and to the non-profit entities that

receive funds from the General Fund, monthly and in advance, the budgetary allotments corresponding to one twelfth of the annual allocation provided in the budget resolution for each entity. Such one-twelfth monthly allocation to each entity (except with respect to the Judiciary) shall be subject to the five percent (5%) withholding during the first three quarters of each fiscal year.

- The Director of OMB may authorize the disbursement of up to ninety-five percent (95%) of each appropriation during the first three quarters of a fiscal year. The Director of OMB shall withhold the remaining five percent (5%) of each appropriation until after the end of the third quarter of a fiscal year. Such withheld percentage of each appropriation shall only be disbursed during the fourth quarter of the fiscal year if the first 6 months of actual revenues reported to the Oversight Board reach the Government's monthly revenue projections for that period and subject to the prior approval of the Director of OMB. If actual revenues for the first 6 months of the fiscal year fail to reach the Government's monthly revenue projections for that period, the amount of the withheld percentage of each appropriation that may be encumbered shall be reduced proportionally according to the negative budget variance between projected and actual revenues.
  - No later than 45 days after the closing of each quarter of a fiscal year, the Secretary of Treasury shall revise the projected net revenues of the General Fund for the current fiscal year (the "Quarterly Revision") and notify the revision to the Director of the OMB, the Governor and the Oversight Board. The Quarterly Revision shall project future revenues based on actual revenues, and include revisions to the assumptions used to generate the General Fund's net revenue projections.
- All appropriations authorized in any prior fiscal year payable from the General Fund, including appropriations without a specific fiscal year, are eliminated and no disbursement of public funds may be covered by such appropriations, except: (1) appropriations without a specific fiscal year to carry out permanent improvements that have been accounted for and kept on the books; and (2) the portion of the appropriations authorized for a specific fiscal year that have been encumbered on or before June 30 of such fiscal year, which shall be kept in the books for 60 days after the termination of that fiscal year and after those 60 days no amount shall be drawn against such portion for any reason. This restriction on the use of appropriations of prior fiscal years shall not apply to: (1) programs financed in whole or in part with federal funds; or (2) orders by the United States district court with jurisdiction over all matters under Title III of PROMESA.
- Any power of OMB, AAFAF, or the Department of the Treasury, including the authorities granted under Act 230-1974, as amended, known as the "Puerto Rico Government Accounting Act" ("Act 230"), to authorize the reprogramming or extension of appropriations of prior fiscal years is hereby suspended. Notwithstanding this section, the appropriations approved in the budget certified by the Oversight Board may be modified or reprogrammed with the approval of the Oversight Board.
  - In conjunction with the reports that the Governor must submit to the Oversight Board no later than 15 days after the last day of each quarter of the fiscal year pursuant to Section 203 of PROMESA, the Executive Director of AAFAF and the Director of the OMB will certify to the Oversight Board that no appropriation of any previous fiscal year (except for appropriations covered by the exceptions authorized in the budget) has been used to cover any expense.
- As requested by the Governor, the New Fiscal Plan includes the enrollment of police under the age of 40 in Social Security beginning in FY19 instead of FY20, once necessary changes to their pension programs have been implemented. An appropriation in the amount of \$14.0 million contemplated in the New Fiscal Plan for costs related to the enrollment of police officers into Social Security (the "Social Security Reserve") shall remain unencumbered and under the custody of OMB until police officers under the age of 40 are covered by Social Security in accordance with Chapter 16 of the New Fiscal Plan, including:

(i) implementation of a defined contribution retirement plan for police officers; (ii) an employee contribution of not more than 2.3% for police officers under the age of 40 as of June 30, 2018 or hired after such date; and (iii) the Social Security Reserve funds are only used to cover the employer's share of the Federal Insurance Contributions Tax (FICA) that corresponds to the police officers enrolled in Social Security. When the aforementioned conditions are satisfied, OMB shall transfer the Social Security Reserve to the Department of Public Safety.

- The emergency reserve under the custody of OMB required by the New Fiscal Plan may not be used to cover any allocation or expense whatsoever without the approval of the Oversight Board.
- In conjunction with the reports that the Governor must submit to the Oversight Board not later than 15 days after the last day of each quarter of the fiscal year according to Section 203 of PROMESA, the Executive Director of AAFAF and the Director of OMB will certify to the Oversight Board that no amount of the (i) Social Security Reserve or (ii) Emergency Reserve has been used unless the Executive Director of AAFAF and the Director of OMB certify to the Oversight Board that the corresponding conditions described in above have been satisfied.
- As a rule, necessary for the responsible disbursement of budgetary allocations for operating and other expenses, OMB may withhold from any of the allocations to the agencies of the Executive Branch the amounts necessary to pay for the pay-go contribution, unemployment insurance, or taxes withheld from their employees, when OMB determines that such a withholding is necessary to ensure compliance with these obligations by the agencies concerned. Any such amounts withheld by OMB shall solely be reprogrammed to pay the corresponding outstanding obligations related to PayGo contributions, unemployment insurance, or taxes withheld from employees.
- The public agencies and instrumentalities, public corporations, and municipalities, with the approval of the Office of Management and Budget, in accordance with current legislation, are authorized to formalize agreements with the Federal Government, other public agencies and instrumentalities, public corporations, or municipalities for the rendering of services based on contracts or the matching of municipal funds and those included in the budget resolution.
- The Office of Management and Budget and the Department of the Treasury are authorized to establish the necessary mechanisms to ensure that when implementing the concept of mobility, pursuant to the provisions of Law 8-2017, as amended, known as the "Puerto Rico Human Resources Management and Transformation in the Government Act," the corresponding transfer of funds allocated to payroll and related costs of said employee are to be carried out simultaneously.
- The Secretary of Treasury, the Director of the OMB, and the Treasurer and Executive Director of each agency or Public Corporation covered by the New Fiscal Plan shall be responsible for not spending or encumbering during a fiscal year any amount that exceeds the appropriations authorized for such year. This prohibition applies to every appropriation set forth in a budget certified by the Oversight Board, including appropriations for payroll and related costs. Any violation of this prohibition shall constitute a violation of the New Fiscal Plan and the applicable budget certified by the Oversight Board.
- For the avoidance of doubt, any reference within the budget to AAFAF, the Department of Treasury, or OMB, or any of their respective officers, shall apply to any successor thereof.
- The Director of OMB, the Secretary of Treasury, the Executive Director of AAFAF, and any successor thereof, shall each be responsible for enforcing compliance of the budget as certified by the Oversight Board. For the avoidance of doubt, such government officials shall each be responsible for complying with the accountability controls existing under Puerto Rico law as of the date hereof.

- On or before July 31 of each year, the Governor shall provide to the Oversight Board budget projections of revenues and expenditures for each quarter of a fiscal year, which must be consistent with the corresponding budget certified by the Oversight Board (the “Quarterly Budget”). The Quarterly Budget shall be provided to the Oversight Board in Excel format and include detailed allocations by agency, public corporation, fund type and concept of spend. Together with the report that the Governor must provide under Section 203 of PROMESA not later than 15 days after the last day of each quarter, the Governor shall provide a quarterly variance analysis that is consistent with modified accrual accounting.
- If during the fiscal year the government fails to comply with the liquidity and budgetary savings measures required by this New Fiscal Plan, the Oversight Board may take all necessary corrective action, including the measures provided in PROMESA Sections 203 and 204.

## PART V. Conclusion

**The New Fiscal Plan is the result of many months of work-sessions, dialogue, stakeholder engagement, research, and in-depth analysis.** Across these activities, the Oversight Board and the Commonwealth Government collaborated to create a deep and rich fact base to underpin their work, and remained focused on creating an integrated approach to restoring fiscal sustainability and economic opportunity for future generations of Puerto Ricans. The starting point for this plan involved numerous structural inhibitors to growth, over \$120 billion in outstanding debt and unfunded pension obligations, and the devastating impact from a historically destructive natural disaster.

**Yet in the aftermath of Hurricane Maria, Puerto Rico now has a unique economic growth opportunity.** Reconstruction activity will provide economic buoyancy in the short term. PROMESA and Title III provide a temporary stay on Puerto Rico's unsustainable debt service. The New Fiscal Plan lays out a series of practical, proven growth-inducing structural reforms and investments, with a responsible set of fiscal measures to right-size Government to the appropriate level.

**But the next step – implementation of the reforms and measures – will always be the most critical one.** Unfortunately, there is no political will to pass the comprehensive labor reform that Puerto Rico needs to achieve significant economic growth. Therefore, absent the adoption of meaningful structural reforms in addition to those contained in the New Fiscal Plan, the structural challenges that have plagued the economy of Puerto Rico will not be addressed, and the Government will have lost its window to restore long-term opportunity to the people of Puerto Rico. Only with sustained, robust economic-growth will Puerto Rico restore fiscal sustainability, regain access to capital markets, and provide a brighter future for the people of Puerto Rico.

# Appendix

## Chapter 18. MODEL PRESENTATION

### 18.1 Overview of entities covered by and excluded from the New Fiscal Plan

The New Fiscal Plan addresses the finances of central government agencies, component units, and other agencies. Agencies for which an independent fiscal plan is being developed have not been consolidated into the New Fiscal Plan and are only represented to the extent they impact the Commonwealth (**Exhibits 75-77**).

EXHIBIT 75: MAJOR ENTITIES COVERED BY AND EXCLUDED FROM THE NEW FISCAL PLAN

Included	Major Entities Included in the New Fiscal Plan	1. TSA	2. Major CUs	3. Other
		Central Government  Agencies: Department of Education, Department of Health, Police, etc.	ASEM GDB <sup>1</sup> CCPRC PRTC ASES PRITA Ports PBA ADEA HTA <sup>1</sup> DDEC AAFAF UPR <sup>1</sup> HFA SIFC PRCCDA	Roughly 45 additional agencies and component units, such as: Solid Waste Authority and Public Broadcasting Authority
		Individually Reported – Comprises approx. 90% of Fiscal Plan Cash Flow		Not Individually Reported – approx. 10% of Fiscal Plan Cash Flow
Excluded	Major Entities Excluded from the New Fiscal Plan	Puerto Rico Electric Power Authority (PREPA)	PR Aqueduct and Sewer Authority (PRASA)	COFINA
		The Children's Trust Fund	COSSEC	Municipalities

<sup>1</sup> GDB, HTA, and UPR have separate and apart fiscal plans from the Central Government.

<sup>2</sup> Major CUs include the following IFCUs: ASEM, ASES, PRITA, Ports, PBA, ADEA, AAFAF, HFA, SIFC, PRCCDA.

Note: Housing Finance Authority, resources from the Cap Funds (money transferred by HUD for financing projects and repayment of bonds) are not contemplated in the New Fiscal Plan.

EXHIBIT 76: LIST OF ENTITIES COVERED BY THE NEW FISCAL PLAN

ENTITIES INCLUDED IN FISCAL PLAN			
Agency Code	Agency	Agency Code	Agency
8	Office of the Comptroller	43	Puerto Rico National Guard
10	General Court of Justice	49	Department of Transportation and Public Works
11	Traffic Safety Commission	50	Department of Natural and Environmental Resources
14	Environmental Quality Board	55	Department of Agriculture
15	Office of the Governor	60	Citizen's Advocate Office (Ombudsman)
16	Office of Management and Budget	62	Cooperative Development Commission
18	Planning Board	65	Public Services Commission
21	Emergency Management and Disaster Admin Agency	67	Department of Labor and Human Resources
22	Office of the Commissioner of Insurance	68	Labor Relations Board
23	Department of State	69	Department of Consumer Affairs
24	Department of the Treasury	70	State Insurance Fund Corporation (SIFC)
25	Hacienda	71	Department of Health
28	Commonwealth Election Commission	75	Office of the Financial Institutions Commissioner
29	Federal Affairs Administration	78	Department of Housing
30	Office of Admin and Transformation of HR	79	Automobile Accident Compensation Admin (ACAA)
31	General Services Administration	81	Department of Education
34	Investigation, Prosecution and Appeals Commission	82	Institute of Puerto Rican Culture
35	Industrial Tax Exemption Office	87	Department of Sports and Recreation
36	Office of the Commissioner of Municipal Affairs	89	Horse Racing Industry and Sport Administration
37	Civil Rights Commission	90	Medical Services Administration (ASEM)
38	Department of Justice	95	Mental Health and Addiction Services Administration
40	Puerto Rico Police	96	Women's Advocate Office
100	Legislative Assembly	165	Land Authority of Puerto Rico
105	Industrial Commission	166	Industrial Development Company (PRIDCO)
106	Public Housing Administration	167	Company for the Integral Development of Cantera's Peninsula
109	School of Plastic Arts	168	Ports Authority
119	Dept of Economic Development and Commerce	177	Land Administration
120	Veterans Advocate Office	180	Tourism Company
121	9-1-1 Services Governing Board	184	Solid Waste Authority
122	Department of the Family	186	Culebra Conservation and Development Authority
123	Families and Children Administration	187	Health Insurance Administration (ASES)
124	Child Support Administration	188	PR and the Caribbean Cardiovascular Center Corp
126	Vocational Rehabilitation Administration	189	Institute of Forensic Sciences
127	Admin for Socioeconomic Develop of the Family	191	Musical Arts and Stagecraft Corporation
133	Natural Resources Administration	192	Fine Arts Center Corporation
137	Department of Correction and Rehabilitation	193	Office of Government Ethics
138	Institutional Trust of the National Guard of Puerto Rico	195	Economic Development Bank
139	Parole Board	196	Public Broadcasting Corporation
141	Telecommunication's Regulatory Board	198	Farm Insurance Corporation
152	Elderly and Retired People Advocate Office	200	Special Independent Prosecutor Panel
153	Advocacy for Persons with Disabilities of the CW of PR	208	Contributions to Municipalities (CRIM)
155	State Historic Preservation Office	211	AFICA
161	Infrastructure Financing Authority	215	Conservatory of Music
162	Public Buildings Authority (PBA)	220	Correctional Health

ENTITIES INCLUDED IN FISCAL PLAN			
Agency Code	Agency	Agency Code	Agency
221	Emergency Medical Services Corps	288	UPR Comprehensive Cancer Center
231	Health Advocate Office	289	Energy Commission
235	Housing Financing Authority (HFA)	290	Energy Affairs Office
238	Port of the Americas Authority	293	Center for Research, Education and Medical Services for Diabetes
241	Administration for Integral Development of Childhood	294	Bosque Modelo de Puerto Rico
258	Puerto Rico Trade and Export Company	295	Fiscal Agency and Financial Advisory Authority (AAFAF)
264	Martín Peña Canal ENLACE Project Corporation	303	Convention Center District Authority (PRCCDA)
265	Roosevelt Roads Naval Station Redevelopment	329	Socio-Economic Development Office
268	Institute of Statistics	928	Government Employee Retirement System (ERS)
273	Permit Management Office	928	Judicial Retirement System (JRS)
276	Public-Private Partnership Authority	929	Teacher Retirement System (TRS)
277	Agricultural Enterprises Development Admin (ADEA)		Additional (Electronic) Lottery
278	Puerto Rico Education Council		Maritime Shipping Authority
279	Public Service Appeals Commission		Special Communities Perpetual Trust
281	Office of the Electoral Comptroller		Traditional Lottery
285	Puerto Rico Integrated Transport Authority (PRITA)		Unemployment Insurance Fund
286	Ponce Port Authority		Corp for the Industries of Blind, Mentally Retarded, and Other Disabled People of Puerto Rico
287	Corporation ELA Regional Center of PR		

#### EXHIBIT 77: LIST OF ENTITIES EXCLUDED FROM THE NEW FISCAL PLAN

Entities issuing standalone fiscal plan		
▪ Development Bank for PR	▪ PR Electric Power Authority	▪ Public Corporation for the Supervision and Deposit Insurance of Puerto Rico Cooperatives
▪ Aqueduct and Sewer Authority	▪ PR Highways and Transportation Authority <sup>1</sup>	▪ University of Puerto Rico <sup>2</sup>
▪ COFINA		
Entities excluded from fiscal plan		
▪ Agency Fund (Special Deposit Fund)	▪ Puerto Rico Municipal Finance Agency	▪ Safe Drinking Water Treatment Revolving Loan Fund
▪ Commonwealth of Puerto Rico Regional Center Corporation	▪ Puerto Rico Municipal Finance Corporation	▪ The Children's Trust Fund
▪ Public Finance Corporation (PFC)	▪ Puerto Rico Water Pollution Control <u>Revolv.</u> Fund	▪ Tourism Development Fund
▪ Puerto Rico Government Investment Trust Fund		
<sup>1</sup> Commonwealth Fiscal Plan includes HTA general fund appropriations <sup>2</sup> Commonwealth Fiscal Plan includes UPR general fund appropriations		

## Chapter 19. MACROECONOMIC PROJECTIONS

### 19.1 Incorporation of historical macroeconomic indicators for Puerto Rico

While the New Fiscal Plan projects relatively steady growth after FY2018, the macroeconomic projections do not ignore the past macroeconomic trajectory of the Island. Historic economic performance remains a core driving factor for future projections, and without the implementation of structural reforms, the economy returns to the previous trendline once disaster spend begins to wane. As shown below (**Exhibits 78-80**), the nominal GNP of the Island continues to grow in the status quo, even while real output has shrunk considerably in the last decade. With current projections, the Island's real output (which excludes elevated inflation) does not return to pre-hurricane levels until at least FY2023-FY2024.

EXHIBIT 78: MACROECONOMIC TRENDLINE BEFORE AND AFTER HURRICANE MARIA

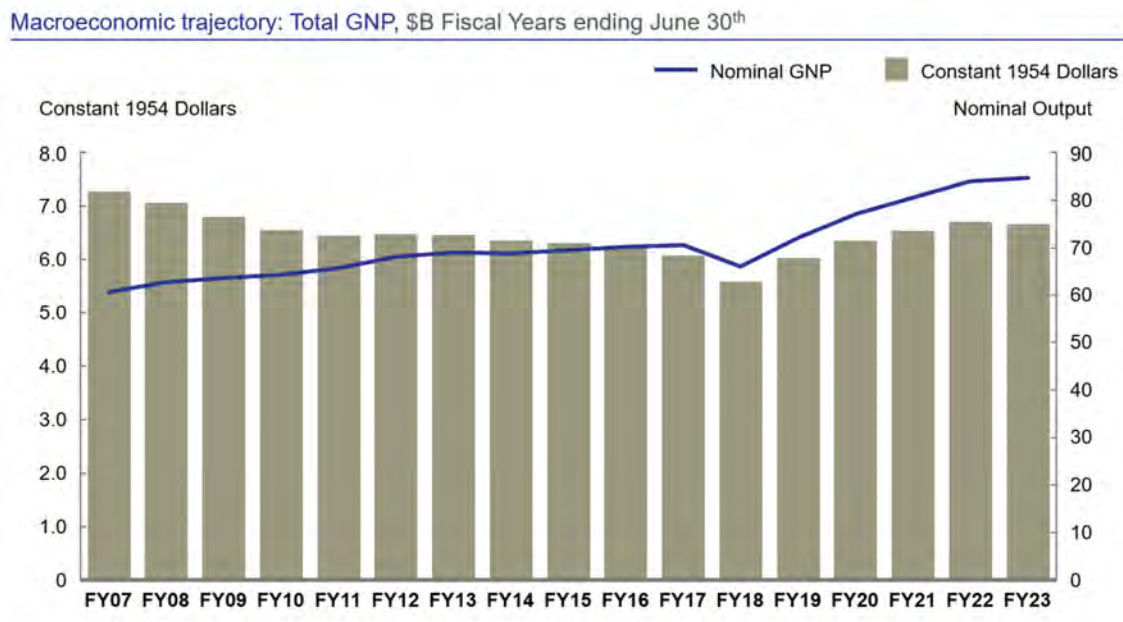
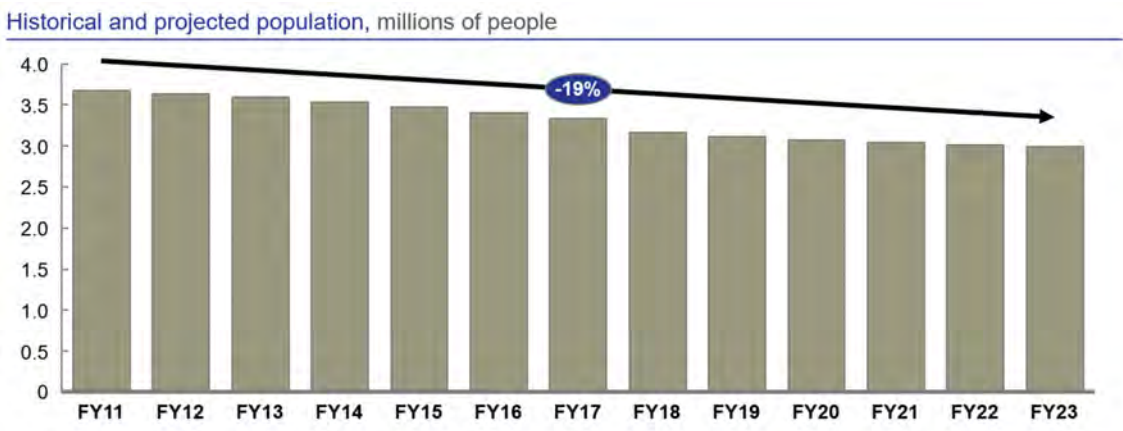
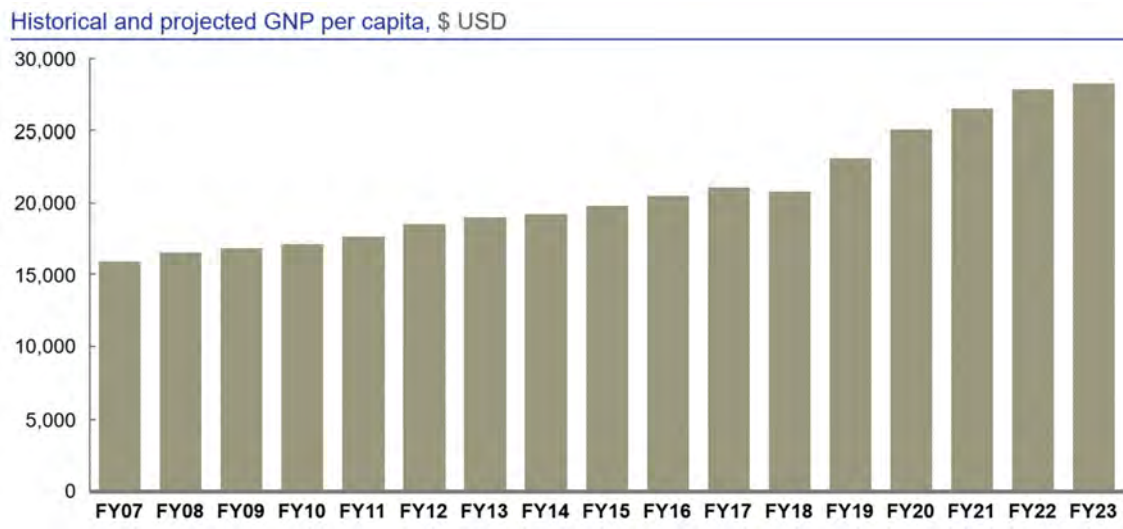


EXHIBIT 79: POPULATION DECLINE



# EXHIBIT 80: PER CAPITA GNP GROWTH



## Chapter 20. FINANCIAL PROJECTIONS

### 20.1 Financial projection methodology

Revenue and expenditure forecasts are largely driven by macroeconomic projections like Puerto Rico inflation and GNP forecasts. For certain critical line items (such as Component Unit revenues and expenditure, pension expenditures and capital expenditures), separate detailed forecasts were developed incorporating historical data and other bottom-up assumptions (**Exhibit 81**).

## EXHIBIT 81: FINANCIAL PROJECTIONS METHODOLOGY

Category	Methodology
1 Macroeconomic Assumptions	<ul style="list-style-type: none"> <li>Quantify acceleration of population decline due to reduced GNP from Hurricane Maria along with natural population factors already contributing to Island population decline (i.e. low fertility rates)</li> <li>Layer in positive impact of disaster relief spend on GNP</li> <li>Reflect impact of fiscal policy on GNP</li> </ul>
2 Baseline Revenue	<ul style="list-style-type: none"> <li>Build from FY18 actual results</li> <li>CIT, PIT, SUT, and motor vehicles revenues normalized for performance related to economic activity spurred by recovery</li> <li>SUT projections adjusted to reflect COFINA settlement</li> <li>FY19 – FY23 projected using appropriate macroeconomic derived growth factors</li> </ul>
3 Baseline Expense (excl. capex, Medicaid, pensions, title III)	<ul style="list-style-type: none"> <li>Built from FY18 budget normalized for non-recurring items</li> <li>Reconciliation adjustment is removed from FY18 budget and projected period</li> <li>FY19 – FY23 projected using appropriate macroeconomic derived growth factors, with appropriate spending freezes incorporated</li> </ul>
4 Revenue Measures	<ul style="list-style-type: none"> <li>Detailed assumptions listed in “Government Transformation” Section (Part V) and explored in depth throughout Chapter 14</li> <li>Determine and incorporate fiscal impact of new policy decisions</li> <li>Impact of measures is layered over baseline</li> </ul>
5 Expense Measures	<ul style="list-style-type: none"> <li>Detailed assumptions listed in “Government Transformation” Section</li> <li>Determine and incorporate fiscal impact of new policy decisions</li> <li>Impact of measures is layered over baseline</li> </ul>
6 Component Units	<ul style="list-style-type: none"> <li>Individual projections for 13 independently forecasted major component units</li> <li>Updated information and utilized Certified Fiscal Plan approach for remaining component units</li> </ul>
7 Capex	<ul style="list-style-type: none"> <li>Assumes total maintenance capital expenditures of \$400 mm in FY18, (including capital expenditures related appropriations to HTA and UPR) grown annually by inflation. Investment capex included in disaster relief spend build up.</li> </ul>
8 Pension	<ul style="list-style-type: none"> <li>AAFAF actuaries provided updated analysis of pension funding requirements based on latest actuarial reports and consideration of new laws</li> </ul>
9 Disaster Relief	<ul style="list-style-type: none"> <li>Analyze funding rollout in past comparable post-disaster environments (i.e. Hurricane Katrina)</li> <li>Conduct conversations with FEMA to understand expected funding and speed of rollout</li> <li>Identify external funding sources, internal funding requirements, and statutory allocations to Puerto Rico</li> </ul>
10 Title III professional fees	<ul style="list-style-type: none"> <li>FY18 Title III professional fees based on FY18 YTD Title III fee applications and professional specific forecasts; FY19-23 forecasted assuming plan of adjustment in FY19 and reasonable tail fees thereafter; projections do not incorporate risk of extended litigation related to fiscal plan defense</li> </ul>

## 20.2 Detailed financial projections

The following section discusses the financial projections across each revenue and expenditure line item from FY2018-FY2023. They also discuss the trajectory of key macroeconomic indicators such as population and GNP per capita over the next five years (**Exhibit 82**). Most revenues track with the overall macroeconomic trajectory of the Island (**Exhibit 83**). Baseline expenditures remain relatively constant over the next five years before measures are applied, especially when social programs are excluded (**Exhibit 84**). This consistency is in large part due to freezes on various expenditures that have been put in place by the Government of Puerto Rico. Finally, the cumulative value of measures grows through FY2023 as there is full implementation of various revenue and expenditure fiscal measures.

EXHIBIT 82: MACROECONOMIC OVERVIEW OF PUERTO RICO, FY2018-FY2023

Six-year financial projections post-measures and structural reforms, units as labeled, SR = structural reforms

Line item	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023	6Y total
Population, #	3,165,637	3,110,192	3,070,254	3,038,297	3,013,188	2,992,205	
Population growth rate, %	(5.1%)	(1.8%)	(1.3%)	(1.0%)	(0.8%)	(0.7%)	
Real GNP growth, %	(8.0%)	7.9%	5.5%	2.9%	2.5%	(0.7%)	
Nominal GNP, \$M	65,964	72,077	77,201	80,685	84,011	84,725	
Nominal GNP per capita, \$	20,839	23,176	25,146	26,557	27,883	28,317	
Nominal GNP per capita growth, %		11.2%	8.5%	5.6%	5.0%	1.6%	
Inflation, %	1.6%	1.3%	1.5%	1.6%	1.6%	1.5%	
Disaster funding, \$M	12,976	12,855	14,311	11,823	11,696	5,623	69,283
Revenues, \$M	22,244	22,741	22,275	21,311	21,549	21,430	131,549
Commonwealth revenues	15,545	15,611	16,241	16,377	16,536	16,336	96,647
Federal transfers	6,699	7,130	6,034	4,933	5,013	5,093	34,902
Expenditures, \$M	(20,017)	(20,106)	(18,878)	(18,644)	(18,401)	(18,506)	(114,552)
Commonwealth-funded expenditures	(13,457)	(13,091)	(12,951)	(13,812)	(13,484)	(13,505)	(80,299)
Federally funded expenditures	(6,560)	(7,015)	(5,927)	(4,832)	(4,917)	(5,002)	(34,253)
Gap/surplus, \$M	2,227	2,635	3,397	2,666	3,148	2,923	16,997
Contractual debt service payments <sup>2</sup> , \$M	(1,745)	(1,770)	(1,798)	(1,742)	(1,767)	(1,782)	(10,603)
Net gap / surplus, \$M	482	865	1,599	924	1,381	1,142	6,394

1 Includes implementation costs, e.g., EITC

2 Debt service based on prepetition contractual debt obligations. Presented for illustrative purposes only and does not represent anticipated future payments on restructured debt. Includes GO, PBA, CCDA, PRIFA, PFC, ERS, PRIDCO. The New Fiscal Plan does not assume any predetermined outcome of ongoing litigation with respect to GO bonds.

Without fiscal and structural measures, the six-year surplus is expected to total \$3.9 billion. After the application of fiscal measures, and the fiscal impact of structural reforms, the six-year surplus becomes \$17.0 billion.

EXHIBIT 83: REVENUE BREAKDOWN SHOWS GRADUAL POST-HURRICANE RECOVERY

Revenue Detail Post-Measures and Structural Reforms

Fiscal Year Ending June 30, \$M	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023	6Y total
<b>Revenues</b>							
General Fund Revenues:							
Individual Income Taxes	1,960	2,119	2,300	2,366	2,456	2,403	13,604
Corporate Income Taxes	1,776	1,897	2,091	2,112	2,184	2,058	12,119
Non-Resident Withholdings	637	649	657	629	592	593	3,758
Alcoholic Beverages	264	263	263	265	267	269	1,592
Cigarettes	121	120	120	121	122	124	728
Motor Vehicles	407	377	404	422	440	443	2,493
Excises on Off-Shore Shipment Rum	215	212	213	214	206	198	1,259
Other General Fund Revenue	324	354	379	396	413	416	2,283
<b>Total</b>	<b>5,705</b>	<b>5,992</b>	<b>6,429</b>	<b>6,526</b>	<b>6,680</b>	<b>6,505</b>	<b>37,836</b>
SUT Collections (excl. 53.65% PSTBA, FAM & CINE)	1,647	2,184	2,366	2,459	2,558	2,534	13,748
Act 154 Collections	1,915	1,831	1,691	1,447	1,199	1,199	9,282
PREPA Loan Repayment	5	135	9	9	9	9	175
<b>General Fund Revenue</b>	<b>9,271</b>	<b>10,142</b>	<b>10,494</b>	<b>10,441</b>	<b>10,446</b>	<b>10,247</b>	<b>61,041</b>
Component Unit Revenue	1,521	1,622	1,689	1,722	1,763	1,756	10,074
Additional SUT (53.65% PSTBA, FAM & CINE)	865	131	140	146	152	153	1,587
Third party ASES receipts (rebates and municipal contributions)	385	396	401	408	417	426	2,433
Other Tax Revenues	2,437	2,496	2,549	2,586	2,588	2,570	15,226
Other Non-Tax Revenues	1,030	583	582	591	600	609	3,996
SRF-OI revenues for agencies	-	6	8	20	20	20	75
<b>Adj. Revenue Before Measures</b>	<b>15,510</b>	<b>15,376</b>	<b>15,862</b>	<b>15,915</b>	<b>15,986</b>	<b>15,782</b>	<b>94,431</b>
Revenue Measures	35	235	379	462	550	554	2,216
<b>Adj. Revenue Post Measures (Excl. Federal Transfers)</b>	<b>15,545</b>	<b>15,611</b>	<b>16,241</b>	<b>16,377</b>	<b>16,536</b>	<b>16,336</b>	<b>96,647</b>
Federal Transfers to Central Government	4,221	4,246	4,298	4,358	4,420	4,483	26,026
Federal Transfers - Medicaid	2,301	2,720	1,572	411	427	445	7,876
Federal Transfers to Independent Component Units	176	164	164	165	165	166	1,000
<b>Revenues Post Measures</b>	<b>22,244</b>	<b>22,741</b>	<b>22,275</b>	<b>21,311</b>	<b>21,549</b>	<b>21,430</b>	<b>131,549</b>

General fund revenues are expected to increase from \$9.3 billion to \$10.2 billion between FY2018 and FY2023, mainly due to GNP growth but bolstered by recovery-related economic activity over the reconstruction period post-hurricane. Federal transfers (excluding disaster assistance) is expected to total ~\$35 billion over the six-year period.

## EXHIBIT 84: POST-HURRICANE EXPENDITURES

Expense detail post-measures and structural reforms							
Fiscal Year Ending June 30, 3M	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023	6Y total
<b>Expenses</b>							
General Fund Expenditures:							
Direct Payroll	(3,027)	(2,990)	(3,010)	(3,048)	(3,088)	(3,133)	(18,293)
Non-Personnel Operating Expenses	(1,370)	(1,348)	(1,385)	(1,384)	(1,403)	(1,423)	(8,293)
Utilities	(257)	(514)	(341)	(347)	(339)	(358)	(2,155)
Municipal Expenses	(298)	(220)	(220)	(220)	(220)	(220)	(1,398)
Pension Expenses	(2,254)	(2,259)	(2,274)	(2,294)	(2,313)	(2,336)	(13,730)
Disaster Recovery Cost Match	-	-	-	-	-	-	-
Restructuring / Title III Costs	(132)	(333)	(251)	(208)	(174)	(158)	(1,252)
UPR Appropriation and Other GF Expenses	(878)	(717)	(717)	(717)	(717)	(717)	(4,284)
Loan to PREPA	(300)	-	-	-	-	-	(300)
<b>Total General Fund Expenses (excl. inter gov transfers)</b>	<b>(8,316)</b>	<b>(8,381)</b>	<b>(8,178)</b>	<b>(8,215)</b>	<b>(8,252)</b>	<b>(8,342)</b>	<b>(49,684)</b>
Medicaid - commonwealth funded	(123)	-	(1,182)	(2,433)	(2,525)	(2,831)	(8,873)
Social Programs - commonwealth funded	(15)	(15)	(15)	(15)	(15)	(15)	(91)
<b>Total General Fund Expenses (excl. inter gov transfers)</b>	<b>(8,454)</b>	<b>(8,396)</b>	<b>(9,354)</b>	<b>(10,663)</b>	<b>(10,793)</b>	<b>(10,988)</b>	<b>(58,649)</b>
Federal Funds, SRF, and CU operating expenses:							
Direct Payroll	(1,595)	(1,571)	(1,819)	(1,648)	(1,877)	(1,705)	(9,785)
Non-Personnel Operating Expenses	(2,311)	(2,357)	(2,398)	(2,419)	(2,430)	(2,450)	(14,363)
Medicaid - federally funded	(2,301)	(2,720)	(1,572)	(411)	(427)	(445)	(7,876)
Medicaid - SRF	(385)	(398)	(401)	(408)	(417)	(426)	(2,433)
Social Programs - federally funded	(2,734)	(2,765)	(2,803)	(2,846)	(2,889)	(2,932)	(16,970)
Other expenses	(20)	(20)	(20)	(20)	(21)	(21)	(122)
<b>Total CW Funded Op. Exp.</b>	<b>(17,769)</b>	<b>(18,355)</b>	<b>(18,297)</b>	<b>(18,544)</b>	<b>(18,783)</b>	<b>(19,098)</b>	<b>(110,848)</b>
Expense Measures	49	829	1,822	2,385	2,861	2,848	10,174
<b>Total CW Funded Op. Exp. Post Measures excl. Loss of Medicaid Funding</b>	<b>(17,720)</b>	<b>(17,726)</b>	<b>(16,676)</b>	<b>(16,179)</b>	<b>(16,122)</b>	<b>(16,251)</b>	<b>(100,674)</b>
<b>Net Operating Surplus/(Deficit)</b>	<b>4,524</b>	<b>5,015</b>	<b>5,599</b>	<b>5,132</b>	<b>5,427</b>	<b>5,179</b>	<b>30,875</b>
Capex and Other Expenses							
Maintenance Capex	(147)	(281)	(302)	(318)	(329)	(335)	(1,709)
Enterprise funds	(1,184)	(1,199)	(1,217)	(1,237)	(1,256)	(1,275)	(7,368)
Disbursements of Tax Revenues to Entities Outside Plan	(873)	(778)	(562)	(711)	(894)	(848)	(4,084)
Other Non-Recurring	(292)	(122)	(122)	(202)	-	-	(737)
<b>Total Capex and Other Expenses</b>	<b>(2,296)</b>	<b>(2,379)</b>	<b>(2,202)</b>	<b>(2,466)</b>	<b>(2,279)</b>	<b>(2,258)</b>	<b>(13,878)</b>
<b>Surplus Post Measures (excl. Debt Payments)</b>	<b>2,227</b>	<b>2,635</b>	<b>3,397</b>	<b>2,666</b>	<b>3,148</b>	<b>2,923</b>	<b>16,997</b>
Contractual Debt Service Payments <sup>1</sup>	(1,745)	(1,770)	(1,798)	(1,742)	(1,787)	(1,782)	(10,603)
<b>Surplus after Measures and Debt Payments</b>	<b>482</b>	<b>865</b>	<b>1,599</b>	<b>924</b>	<b>1,361</b>	<b>1,142</b>	<b>6,394</b>

<sup>1</sup> Debt service based on prepetition contractual debt obligations. Presented for illustrative purposes only and does not represent anticipated future payments on restructured debt.

## Chapter 21. STRUCTURAL REFORMS

### 21.1 Human capital and welfare reform

States across the mainland U.S. have different approaches to labor market and welfare policy, including different employee protections, incentives for employers, or benefits to workers. California and Florida represent opposite ends of this spectrum of approaches, with California intervening more in the labor market while Florida requires little above what is required by the federal Fair Labor Standards Act. At the same time, these two states allow for much freer and less regulated labor markets than Puerto Rico's approach and both have significantly higher levels of employment, incomes and economic opportunity.

California offers workers more protections and benefits than most states (e.g., mandated paid sick leave and multiple exemptions to employment at-will) while Florida offers very few (e.g., no guaranteed leave, no exceptions to employment at-will). California has one of the highest minimum wages in the country (\$10.50/hour) while Florida offers a lower minimum wage (\$8.25/hour) yet does not require workers to pay state income tax.

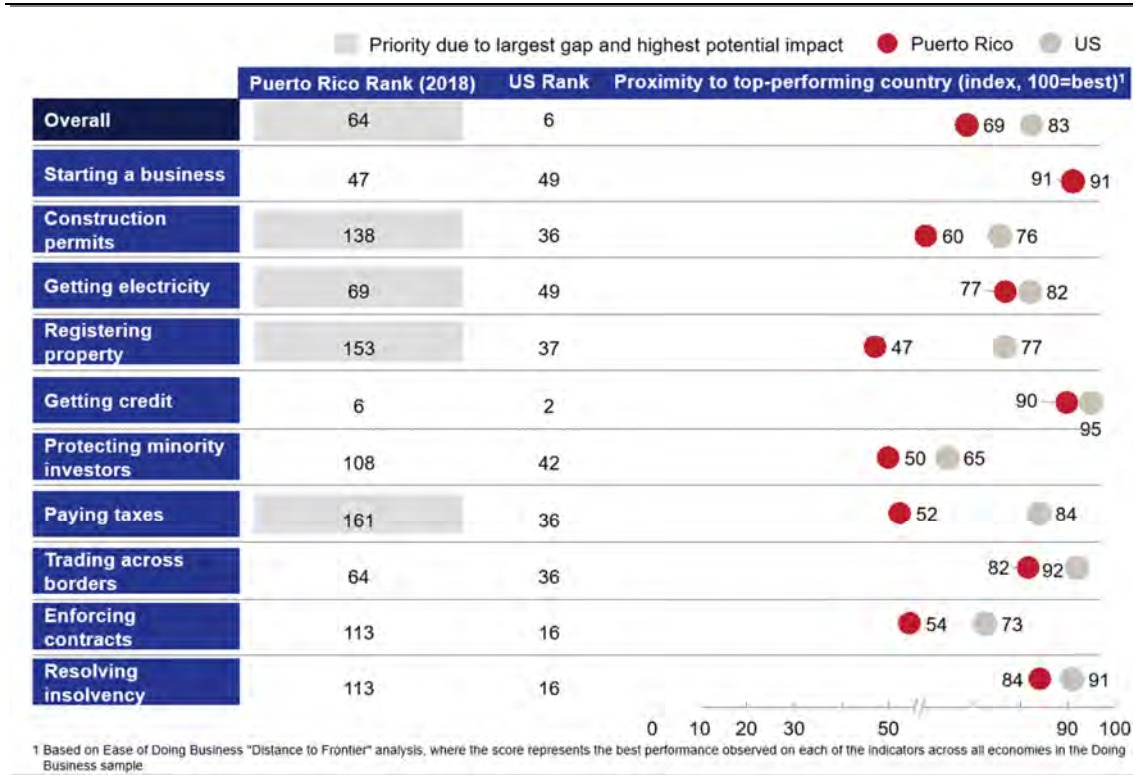
Despite these differences, Florida and California are closer in both labor market environment and outcomes than Puerto Rico: for example, both are employment at-will jurisdictions and have long-term work requirements in place for SNAP, while Puerto Rico has neither. Puerto Rico has more generous policies for "secondary benefits": Florida requires none and California offers 24 hours (3 days) of paid sick leave, while Puerto Rico's guarantees of a yearly Christmas bonus, severance pay, 27 days of paid time off, and maternity leave are far beyond those required by any mainland state.

California's labor force participation rate is 62.3%, and Florida's is 59.4%, versus approximately 40 percent in Puerto Rico.<sup>154</sup> This difference implies that, relative to the size of the population, California and Florida have roughly 50% more individuals in the labor force than Puerto Rico. Put another way, if Puerto Rico increased its labor force participation rates to those of California or Florida, household incomes would rise by roughly 50% and poverty would plummet.

## 21.2 Ease of doing business reform

An analysis of Puerto Rico's Ease of Doing Business rankings across all World Bank indicators shows which are most in need of targeted reforms for improvement (**Exhibit 85**).

EXHIBIT 85: PUERTO RICO'S EASE OF DOING BUSINESS RANKINGS COMPARED TO THE US



## Chapter 22. FISCAL MEASURES

### 22.1 Agency efficiency measures

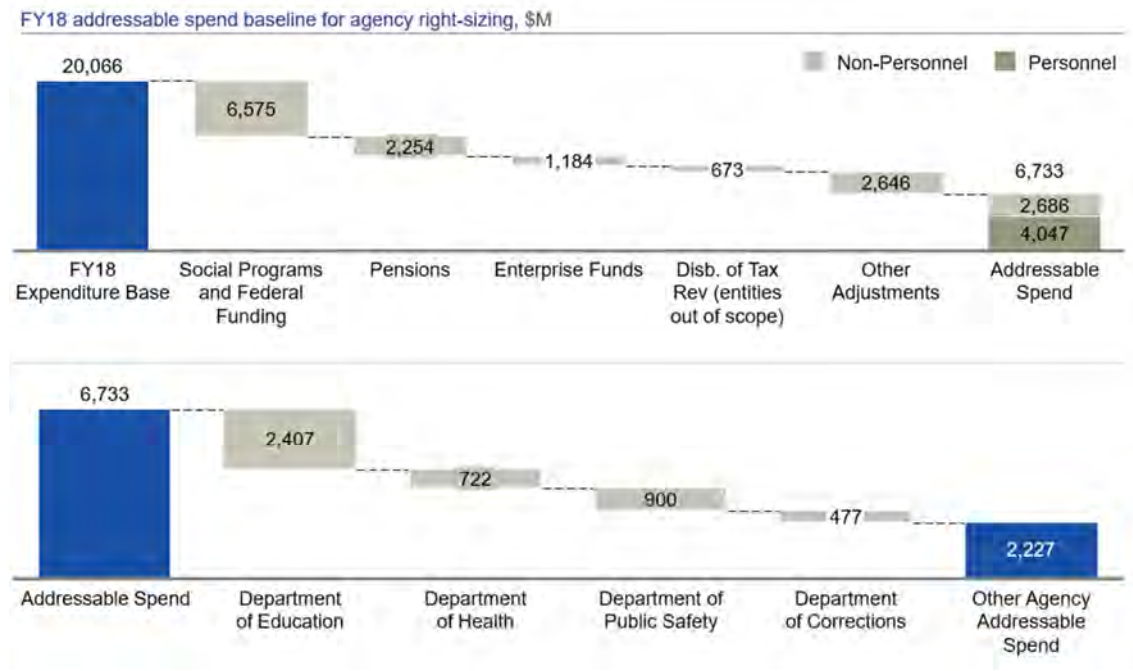
#### 22.1.1 Addressable spend for agency efficiency measures

Not all governmental agency spend was expected to be addressable through rightsizing initiatives. For instance, federal funding to agencies which would disappear if it were not

<sup>154</sup> U.S. Department of Labor, Bureau of Labor Statistics, "Local Area Unemployment Statistics," March 23, 2018

allocated to its current use were not targeted for reductions. Below is an overview of the approach used to determine which funds and cost concepts were addressable (**Exhibit 86**).

**EXHIBIT 86: ADDRESSABLE SPEND BASE FOR AGENCY EFFICIENCIES**



The following cost concepts are assumed to be addressable for spend reductions within Agency Efficiencies (see *Chapter 12*).

- **Personnel expenditures.**
  - Payroll and related costs (Nómina y costos relacionados)
- **Non-personnel expenditures.**
  - Materials and supplies (Materiales y suministros)
  - Purchase of equipment (Compra de equipo)
  - Transportation expenditures (Gastos de transportación)
  - Other operating expenditures (Otros gastos operacionales)
  - Purchased services (Servicios comprados)
  - Announcements and guidelines in media (Anuncios y pautas en medios)
  - Facilities and payments for public services (Facilidades y pagos por servicios públicos)
  - Professional services (Servicios profesionales)
  - Utilities
- **Non-personnel expenditures partially included.** The following cost concept was determined to be a miscellaneous category that included a collection of both addressable and non-addressable spend. Therefore, while all category spend was included in the addressable spend baseline, only 50% of category spend was included in actual savings initiatives as a haircut to separate addressable and non-addressable spend
  - Enrolled assignments (asignaciones englobadas)

- **Non-personnel expenditures included on a case-by-case basis.** The following cost concepts were included as addressable spend, and individual decisions were made to determine whether each agency's costs within those concepts were addressable within Agency Efficiencies, or whether they did not represent addressable spend (e.g., governmental transfer payments, tax incentives which were addressed via corporate tax reform, etc.)
  - Government entities (Entidades gubernamentales)
  - Contributions to non-governmental entities (Aportaciones a entidades no gubernamentales)
  - Donations, subsidies and distribution (Donativos, subsidios y distribuciones)
- **Out of scope.** The following cost concepts were excluded from agency efficiencies for a variety of reasons (e.g., payments related to debt service or pensions, liquidity reserves, etc.)
  - Assignment pareo federal funds (Asignación pareo fondos federales)
  - Budget reserve (Reserva presupuestaria)
  - Investment in permanent improvements (Inversión en mejoras permanentes)
  - Payment of pensions - pay as you go (Pago de pensiones - pay as you go)
  - Liquidity reserve (Reserva de liquidez)
  - Adjustment
  - Payment of the debt (Pago de la deuda)

All expenditures funded by the general fund and special revenue funds are assumed to be addressable provided they were expenditures in the above addressable cost concepts (e.g., General Fund expenditures within "Purchased services").

Federal funds and own income were evaluated on a case-by-case basis for inclusion as addressable spend. In cases where federal dollars were explicitly allocated to specific line-items within the budget, those dollars were assumed to be non-addressable. However, in cases where those funds were fungible and could be applied to various expenditures, those dollars were considered addressable within Agency Efficiencies.

### *22.1.2 Agency efficiency measures*

**Back-office or support function payroll savings** come from finding efficiencies by reducing personnel in non-client facing functions in each agency. These positions include administrative roles such as finance, human resources, and information systems, as well as some facilities support.

- a. For standalone agencies, support service payroll savings are calculated at **15-20%**, based on successful public-sector cases primarily involving digitization and process improvement, including the implementation of lean management practices.
- b. For newly merged agencies, back-office or support function payroll savings are calculated at **40-50%**. The single consolidated agency will be able to use scale efficiencies through the combination of support services and elimination of duplicate functions and roles. The savings value is based on private sector examples of mergers and acquisitions and public sector examples of consolidations.
- c. In some cases, more savings can be captured when there is an agency-specific back office initiative that can be identified beyond standard optimization.

**Frontline payroll savings** were identified using a tailored deep-dive for each major agency for both merged and standalone agencies. The approach involved a review of each program and service (both citizen-facing and intergovernmental) to determine if the service levels

provided should continue and/or if specific services could be delivered more effectively (e.g., through process improvement, innovative tools and technology, organizational and delivery changes). For applicable programs, spending levels are benchmarked against appropriate peer governments (either state or federal, or in some cases international examples). Additionally, macroeconomic analysis can be used to determine if lower payroll levels could serve the same number of citizens based on expected changes in demographics, workforce levels, and the economy.

**Non-personnel savings** opportunities were expected to be largely driven through procurement and other streamlining efforts. Initiatives such as institutionalizing centralized demand controls, strategic category-level purchasing (e.g., leveraging Puerto Rico's access to federal GSA rates, purchasing through e-auctions, opening competitive RFPs), accounting for total cost of ownership, and enforcing contractual compliance could present large savings opportunities throughout the government.

Standalone agencies can implement initiatives including strategic sourcing and IT rationalization to better leverage the procurement function at a lower cost. The digitization and process improvement savings initiatives mentioned in support services can apply to procurement as well. Public sector agencies using these methods have saved **20%** on procurement spending.

Newly merged agencies have an additional opportunity to save on operational costs, with achievable savings of **30%**. In addition to the savings that a standalone agency can receive, consolidation of agencies should increase the leverage of Puerto Rican agencies in negotiating with the private sector, and bigger savings can be expected from duplication and combination of efforts. Merged agencies can also expect to find savings based on leveraging their smaller footprint, as well as lowering maintenance and facility costs.

#### **Agency-specific initiatives and targets**

The following **Exhibit 87** details the baseline expenditure and total reduction, annually, for each of the agency groupings within Agency Efficiencies (see *Chapter 12*).

EXHIBIT 87: ADDRESSABLE BASELINE EXPENDITURES AND TOTAL REDUCTION PER AGENCY GROUPING<sup>155</sup>

Grouping	FY15				FY16				FY20			
	Baseline	Personnel reduction	Non-personnel reduction	Total reduction	Baseline	Personnel reduction	Non-personnel reduction	Total reduction	Baseline	Personnel reduction	Non-personnel reduction	Total reduction
Education	2,047,307	-	-	-	2,052,262	10,160	8,721	10,881	2,066,262	133,851	59,289	192,942
Social Welfare - Families & Children	245,328	-	-	-	249,567	1,474	-	1,474	253,402	2,849	-	2,849
Social Welfare - Housing	100,588	-	-	-	101,648	1,209	1,195	2,404	103,902	2,415	2,427	4,845
Health	721,905	-	-	-	742,706	33,086	14,389	47,475	743,638	51,300	25,118	80,418
Public Safety	896,729	-	-	-	900,561	22,317	9,472	31,789	914,592	57,483	19,226	76,710
State Insurance Fund Corporation	350,841	-	-	-	351,670	10,710	4,875	15,585	357,962	21,420	9,901	31,321
Corrections	477,323	-	-	-	479,072	25,731	8,931	34,661	487,474	35,018	25,306	60,327
OCFO - Treasury	315,489	-	-	-	315,653	7,148	13,377	20,523	320,496	13,960	21,830	35,790
Economic Development	181,601	-	-	-	181,900	5,453	8,724	14,177	184,832	10,906	17,706	28,615
Institute of Statistics	1,567	-	-	-	1,558	36	80	117	1,588	73	163	235
Public Works	232,426	-	-	-	233,481	8,230	7,371	13,601	237,676	12,459	14,963	27,422
Executive Office	186,892	-	-	-	187,526	2,635	4,881	7,516	190,912	5,270	9,908	15,178
Labor	65,512	-	-	-	65,707	2,456	3,061	5,547	66,818	5,036	6,275	11,305
Agriculture	88,989	-	-	-	90,044	2,062	391	2,472	91,424	4,163	793	4,956
Airport	105,157	-	-	-	105,311	2,741	1,703	4,445	106,986	5,482	3,458	8,940
Environmental	92,074	-	-	-	92,228	3,614	2,760	6,374	93,709	7,228	5,603	12,830
Drinking Water	8,074	-	-	-	8,062	359	215	614	8,208	797	437	1,234
Culture	24,283	-	-	-	24,445	1,187	831	2,018	24,917	2,374	1,888	4,062
Utilities Commission	27,889	-	-	-	27,880	195	601	719	28,306	236	1,220	1,456
Finance Commission	18,589	-	-	-	18,570	443	600	1,044	18,648	387	1,218	1,605
State	13,470	-	-	-	13,531	514	374	888	13,775	1,029	799	1,798
Land	16,396	-	-	-	16,433	654	402	1,056	16,702	1,308	804	2,112
Universities	11,317	-	-	-	11,366	589	88	677	11,803	863	179	1,042
Independent Agencies	176,553	-	-	-	177,959	4,331	3,133	7,464	181,254	6,516	6,360	12,877
Automobile Accident Compensation Administration	86,262	-	-	-	86,320	1,894	4,012	5,706	90,679	2,915	8,144	10,959
Transparency & Control Entities	313	-	-	-	328	-	-	-	343	-	-	-
Closures	28,039	-	-	-	28,062	11	25	35	28,495	54	125	179
Courts and Legislature	13,292	-	-	-	13,910	20,990	20,800	41,790	14,532	20,809	27,475	48,285
FOMB	60,000	-	-	-	70,000	-	5,250	5,250	75,000	-	5,625	5,625
<b>Total</b>	<b>6,666,796</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>6,651,969</b>	<b>108,088</b>	<b>127,398</b>	<b>295,306</b>	<b>6,785,757</b>	<b>435,436</b>	<b>279,905</b>	<b>795,302</b>

<sup>1</sup> Savings excludes additional personnel savings achievable through compensation measures (e.g., payroll freeze, uniform healthcare, Christmas bonus), SRF deficit reduction, and utilities

<sup>155</sup> Education reinvestment in teacher salaries, text books are baked into number

Grouping	FY21				FY22				FY23			
	Baseline	Personnel reduction	Non-personnel reduction	Total reduction	Baseline	Personnel reduction	Non-personnel reduction	Total reduction	Baseline	Personnel reduction	Non-personnel reduction	Total reduction
Education	2,050,849	218,358	65,998	312,344	2,088,519	277,887	118,900	307,388	2,084,357	314,026	121,100	435,126
Social Welfare - Families & Children	253,154	4,573	237	4,810	253,358	5,800	3,049	8,849	253,825	6,854	5,145	11,934
Social Welfare - Housing	194,579	3,664	3,735	7,399	194,273	3,664	3,794	7,458	195,704	3,664	3,852	7,515
Health	749,671	85,367	44,567	139,984	743,343	71,441	43,146	119,587	751,472	77,359	43,696	126,055
Public Safety	915,708	81,911	28,596	91,507	914,618	82,119	30,061	92,180	915,385	57,740	30,518	88,258
State Insurance Fund Corporation	358,951	32,455	15,241	47,695	355,541	32,455	15,400	47,935	359,318	32,455	15,716	48,171
Corrections	488,600	81,475	30,500	111,975	488,398	81,475	30,641	112,117	490,446	81,475	30,780	112,255
OGFO - Treasury	320,841	21,682	30,739	51,861	320,514	21,183	31,106	52,268	320,632	21,301	31,466	52,767
Economic Development	185,154	18,524	27,260	43,784	184,945	18,524	27,689	44,213	185,286	18,524	28,110	44,634
Institute of Statistics	1,990	110	251	361	1,568	110	255	365	1,588	110	258	368
Public Works	238,255	18,870	23,033	41,911	237,339	18,870	23,395	42,273	238,737	18,878	23,751	42,629
Executive Office	191,509	7,564	15,252	23,236	191,069	7,564	15,492	23,476	192,190	7,564	15,727	23,712
Labor	86,918	7,751	9,860	17,410	86,695	7,554	9,611	17,605	88,022	7,835	9,361	17,695
Agriculture	91,541	8,308	1,221	7,529	91,485	8,308	1,241	7,548	91,517	8,308	1,250	7,567
Justice	107,118	8,306	5,323	13,629	108,892	8,306	5,406	13,713	107,069	8,306	5,480	13,795
Environmental	83,967	10,861	8,625	19,578	83,747	10,861	8,760	19,711	83,620	10,951	8,894	19,845
Ordnance	8,223	1,208	672	1,880	8,223	1,208	683	1,891	8,230	1,208	693	1,901
Culture	24,965	3,597	2,588	6,195	24,702	3,597	2,639	6,236	24,981	3,597	2,679	6,278
Utilities Commission	28,337	357	1,678	2,235	28,312	357	1,908	2,265	28,315	357	1,937	2,294
Finance Commission	16,889	1,343	1,676	3,219	16,858	1,343	1,905	3,248	16,854	1,343	1,934	3,277
State	13,940	1,599	1,189	2,728	13,870	1,599	1,187	2,746	13,841	1,599	1,205	2,764
Land	16,720	1,981	1,219	3,200	16,657	1,981	1,219	3,200	16,705	1,981	1,219	3,200
Universities	11,637	1,115	276	1,381	11,578	1,192	281	1,483	11,671	1,246	285	1,530
Independent Agencies	181,775	8,452	6,791	15,243	180,847	9,047	9,945	18,992	182,213	9,514	10,096	19,610
Automobile Accident Compensation Administration	90,783	3,885	12,537	16,421	90,722	4,343	12,734	16,776	90,734	4,167	12,927	17,094
Transparency & Control Entities	344	-	-	-	322	-	-	-	344	-	-	-
Closures	28,532	108	254	361	28,506	106	258	365	28,524	108	262	369
Courts and Legislature	14,643	21,240	34,627	55,867	13,876	21,346	41,815	63,161	14,792	21,450	49,189	70,631
FOMB	75,000	-	5,625	5,625	75,000	-	5,625	5,625	75,000	-	5,625	5,625
<b>Total</b>	<b>6,773,425</b>	<b>680,532</b>	<b>413,764</b>	<b>1,094,296</b>	<b>6,762,769</b>	<b>675,739</b>	<b>404,823</b>	<b>1,080,562</b>	<b>6,763,435</b>	<b>713,228</b>	<b>405,778</b>	<b>1,119,006</b>

1 Savings excludes additional personnel savings achievable through compensation measures (e.g., payroll freeze, uniform healthcare, Christmas bonus), SRF deficit reduction, and utilities

Agency groupings are as shown below in **Exhibit 88**.

#### EXHIBIT 88: AGENCY GROUPINGS

Agriculture	1	Agricultural Enterprises Development Administration	3	Farm Insurance Corporation
	2	Department of Agriculture		
Courts and Legislature	1	General Court of Justice (GCJ)	2	Legislative Assembly (LA)
Culture	1	Fine Arts Center Corporation	3	Musical Arts and Stagecraft Corporation
	2	Institute of Puerto Rican Culture		
Economic Development	1	Authority for the Redevelopment of Roosevelt Roads Naval Station	6	Permit Management Office
	2	Department of Economic Development and Commerce	7	Planning Board
	3	Energy Affairs Office	8	Puerto Rico Trade and Export Company
	4	Industrial Development Company	9	Regional Center Corporation of Commonwealth of PR
	5	Industrial Tax Exemption Office	10	Tourism Company
Environmental	1	Department of Natural and Environmental Resources	3	Natural Resources Administration
	2	Environmental Quality Board	4	Solid Waste Authority
Executive Office	1	Federal Affairs Administration	5	Office of Socioeconomic Development
	2	Infrastructure Financing Authority	6	Public Buildings Authority
	3	Office of the Commissioner of Municipal Affairs	7	Public-Private Partnership Authority
	4	Office of the Governor	8	State Historical Preservation Office
Finance Commission	1	Office of the Commissioner of Insurance	2	Office of the Financial Institutions Commissioner
Health	1	Center for Research, Education and Medical Services for Diabetes	5	Medical Services Administration
	2	Comprehensive Cancer Center	6	Medical health and Addiction Services Administration
	3	Department of Health	7	Puerto Rico and Caribbean Cardiovascular Center Corporation
	4	Health Insurance Administration		

Justice	1 Department of Justice	2 Parole Board
Labor	1 Department of Labor and Human Resources 2 Investigation, Prosecution and Appeals Commission 3 Labor Relations Board	4 Public Service Appeals Commission 5 Vocational Rehabilitation Administration
Land	1 Land Administration	2 Land Authority
Ombudsman	1 Advocacy for Persons with Disabilities of the Commonwealth of Puerto Rico 2 Elderly and Retired People Advocate Office 3 Health Advocate Office	4 Veterans Advocate Office 5 Women's Advocate Office
Public Works	1 Department of Transportation and Public Works 2 Integrated Transport Authority	3 Ports Authority 4 Traffic Safety Commission
Social Welfare	1 Administration for Integral Development of Childhood 2 Administration for Socioeconomic Development of the Family 3 Child Support Administration 4 Department of the Family	5 Department of Housing 6 Families and Children Administration 7 Housing Financing Authority 8 Public Housing Administration
State	1 Department of State	2 Puerto Rico Education Council
Transparency & Control Entities	1 Office of Government Ethics	2 Office of the Comptroller
Department of Public Safety	1 Puerto Rico Police Department (PRPD) 2 Firefighters Corps 3 Emergency Medical Services Corps 4 Emergency Management and Disaster Administration Agency	5 9-1-1 Services Governing Board 6 Institute of Forensic Sciences 7 Special Investigation Unit
Treasury / OCFO	1 Department of the Treasury 2 Hacienda 3 Oficina de Administración y Transformación de los Recursos Humanos en el Gobierno de PR	4 Office of Management and Budget 5 General Services Administration 6 Fiscal Agency and Financial Advisory Authority
Universities	1 Conservatory of Music	2 School of Plastic Arts
Utilities Commission	1 Puerto Rico Energy Board 2 Public Services Commission	3 Independent Bureau of Consumer Protection 4 Telecommunications Regulatory Board
Closures	1 Model Forest of Puerto Rico 2 Economic Development Bank	3 Culebra Conservation and Development Authority
Independent Agencies	1 Civilian's Advocate Office (Ombudsman) 2 Civil Rights Commission 3 Commonwealth Election Commission 4 Convention Center District Authority 5 Cooperative Development Commission 6 Department of Consumer Affairs 7 Department of Sports and Recreation 8 Industrial Commission 9 Martín Peña Canal ENLACE Project Corporation	10 Office of the Electoral Comptroller 11 Company for the Integral Development of Cantera's Peninsula 12 Port of Ponce Authority 13 Port of the Americas 14 Public Broadcasting Corporation 15 Puerto Rico National Guard 16 Special Independent Prosecutor Panel 17 Teacher's Retirement System 18 Institute of Statistics
Standalone Agencies	1 Automobile Accident Compensation Authority 2 Financial Oversight and Management Board	3 State Insurance Fund Corporation

For each grouping, initiatives include:

- Front-line personnel reductions (by specific benchmark: unique benchmarks based on individual agency, as detailed in appendix, or by population)
- Back-office personnel reductions (by general benchmark: overarching benchmarks which apply to all agencies, as described in *Chapter 12*)
- Non-personnel optimization (by general benchmark)

Specific agency groupings include individualized initiatives, including:

- **Courts and Legislature:** Reduce overall spend in line with mainland benchmarks (LA compared to full-time legislatures, GCJ compared to state judiciaries)
- **Culture:** Reduce Musical Arts and Stagecraft Corporation expenditures (by specific benchmark)
- **Environmental:** Reduce solid waste G&A spend (by specific benchmark)
- **Financial Oversight and Management Board:** Reduce overall spend in line with ~50% of the cuts prescribed to other agencies (same as reduction to AAFAF, which will also prove vital to implementing the New Fiscal Plan)
- **Independent Agencies:** Consolidate Port of the Americas into the Port of Ponce Authority; Institute of Statistics has been kept independent

### ***Closures***

Sole initiative will be to close all relevant agencies. However, there will be no savings from the Economic Development Bank, the Company for the Integral Development of Cantera's Peninsula will be closed only after FY2032, and only ~68% of savings from the Culebra Conservation will be achieved.